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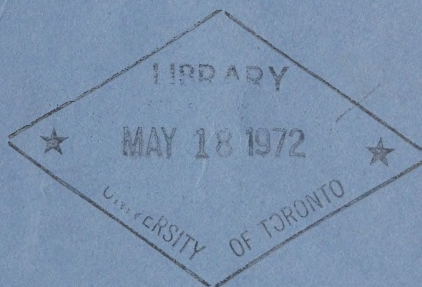


ONTARIO

Committees

MINISTRY OF CONSUMER AND COMMERCIAL RELATIONS

**REPORT OF THE
SECURITIES INDUSTRY OWNERSHIP
COMMITTEE OF THE
ONTARIO SECURITIES COMMISSION**



Issued by the

ONTARIO SECURITIES COMMISSION
555 YONGE STREET, TORONTO 284, ONTARIO

April, 1972




PROVINCE OF ONTARIO

MINISTRY OF CONSUMER AND COMMERCIAL RELATIONS

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PREFACE

The findings, conclusions and recommendations which appear in the pages that follow are based upon the efforts of many people. The most apparent of these, the contributors to the study, are acknowledged in Appendix "A". It is to those who acted as staff and consultants to the study to which we now direct particular attention.

The leader among these is David L. Johnston, whom we recently welcomed as a colleague on the Commission. Mr. Johnston was our Counsel and as such led the research, co-ordinated our efforts, and assisted in all phases in the preparation of the report. He is an Associate Professor on the Faculty of Law, University of Toronto, who has specialized in corporate and securities law. His qualities are well known to the Commission through his work with us, most recently as Counsel to our committee which produced what is known as the Merger Study.

The economic analysis and the financial profile based upon the financial questionnaire was the special province of Mrs. Dagmar Stafl, the Department Economist. Mrs. Stafl was assisted in the collection of information by the Commission's financial analyst, Mr. S. Gorecki, B.Com., C.A. She was primarily responsible for the economic analysis in Chapter III. With the help of Mr. Gorecki and others the information obtained was fleshed out. She directed the collation of this information and provided us with financial analyses based upon it.

The task of collating the financial information was that of Miss Marilyn Walter, B.A. (Econ., U. of T.) who,

with the assistance of Mr. David Jackson, B. Comm. (Medallist, University of Windsor, now completing his Bachelor of Laws degree at Osgoode Hall) prepared the tables and graphs upon which the financial analysis was based. Mr. Jackson, as a law student, was able to assist Professor Johnston in the preparation of footnotes and appendices to the report.

Mr. Gorecki's participation was also on a continuing basis commencing with the preparation of the questionnaire, completing the financial information, testing the financial analysis and the recommendations in Appendices "J" and "K", obtaining information and offering advice as requested.

We also wish to recognize the secretarial staff. We were fortunate in that Miss Mary Grenier, who played such an important role in the reproduction of the Merger Study report, was secretary to Mrs. Stafl and as such assisted Mrs. Stafl and Miss Walter and, in these latter stages, assumed the direct responsibility for typing the bulk of the report and its appendices. Miss Jane Chalmers was for some months secretary to Mr. Johnston and typed earlier drafts of the report. The Vice-Chairman's secretary, Miss Susan Lillie, also played an important role in the completion of the report as well as during the course of the study. Mrs. Mary O'Donnell, the Chairman's secretary, added her support to this important group of ladies.

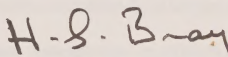
In the body of the report we note the help given to Professor Johnston, Mrs. Stafl and Mr. Gorecki in devising the financial questionnaire by Mrs. H. Salisbury, Economist, from the then Department of Treasury and Economics, and Mr. R. T. Cooper, Director, Research Branch, Department

of Trade and Development. We hope that the facts gathered through this report will add in some measure to the collective knowledge of those two departments.

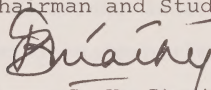
To all of these most important people, and with apologies to those we may have inadvertently omitted, our most sincere thanks.



E. A. Royce, Chairman



H. S. Bray, Q. C., Vice-Chairman and Study Director



James G. K. Strathy, O. B. E., Commissioner

April 21st, 1972

STATEMENT

BY

THE HONOURABLE WILLIAM DAVIS

PREMIER OF ONTARIO

IN THE LEGISLATIVE ASSEMBLY

JULY 13, 1971

Mr. Speaker,

As you are well aware, the subject of foreign ownership of the Canadian economy has occupied a considerable proportion of debate in this House during the current session. Discussion of this complex subject has been very wide, indeed, in recent months, including the examination of the subject at the Ontario Conference on Economic and Cultural Nationalism.

A good deal of the discussion has been associated with the development of our natural resources and the creation of secondary industry, as well as such specific areas as the publishing and book distribution industries.

In the view of the Government, one very large and critical area to the firm establishment of Canadian determination is the investment community.

This Government shares the concern of the Federal Government about foreign ownership of essential Canadian financial institutions. The nature and extent of foreign investment in the Canadian investment community and its implications were examined with some care by the industry's own committee headed by Trevor F. Moore. In parallel areas of concern, in particular Loan and Trust Companies, we enacted legislation restricting foreign ownership.

The Canadian investment community, which has assumed the responsibility for the direction of vast sums of capital in this country, is no less important. The investment community must be responsible and responsive to the particular needs of Canada. Its owners must be amenable to these needs and aspirations.

We believe it to be essential that ownership of investment companies remain substantially Canadian.

Therefore we are now taking steps through the Ontario Securities Commission to ensure that all new entrants into the Ontario investment community meet these standards, with the capital owned or controlled by non-Canadians not exceeding 25 per cent, and no more than 10 per cent being owned or controlled by a single person or associated group of persons who are non-Canadians. These limitations would apply to all classes of securities dealers. They would also apply where there is a material change in the control of an existing registrant.

The Government has requested the Ontario Securities Commission to examine this problem further, concentrating on several matters dealt with in the Moore Report, including the question of public participation in investment companies and the continuing status of existing registrants which are foreign controlled.

Mr. Speaker, this policy of using a 25-10 formula for non-Canadian ownership is consistent with that now in effect in the Loan and Trust field and which we used in connection with the distributors of paperback books. It is a sound yardstick for use in most areas involving foreign ownership, enabling the encouragement of foreign investment and funds while protecting our own Canadian interests.

TERMS OF REFERENCE
ONTARIO SECURITIES COMMISSION
INDUSTRY OWNERSHIP STUDY

In accordance with the request made by the Honourable William Davis, the Prime Minister of Ontario, on July 13th 1971, the Ontario Securities Commission have appointed a committee of its members to examine the problems inherent in non-resident ownership of securities registrants and the requirements and sources of capital available to the investment community including public financing.

The Committee is composed of:

Chairman	- E.A. Royce
Vice Chairman (who will act as the Study Director)	- H.S. Bray, Q.C.
Commissioner	- J.G.K. Strathy, O.B.E.

TERMS OF REFERENCE

The Committee proposes directing its attention to the following questions:

1. Should registrants be permitted to obtain additional capital from outside investors by way of,
 - (a) sale of equity stock; or
 - (b) sale of debt instruments?
2. If such outside financing is permitted, what safeguards and restrictions appear appropriate?
3. As to the question of non-resident ownership, under what circumstances and upon what terms should existing registrants, who now exceed the allowable limits, be required to reduce their non-resident ownership to the levels established for new applicants?
4. Should non-resident owners be permitted to provide additional financing by way of loans or guaranteeing loans and, if so, what limits or restrictions are appropriate?
5. Should the registration of a registrant controlled by a non-resident be permitted to continue where,
 - (a) it obtains capital in a manner significantly different from that permitted to Ontario registrants generally;
 - (b) there is any material change in the non-resident owners; or
 - (c) it merges, amalgamates or experiences another corporate reorganization?

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CHAPTER I

INTRODUCTION TO THE STUDY

July 13th, 1971

1.01 The Honourable William G. Davis, the Premier of Ontario, advised the Legislative Assembly on July 13th, 1971, that his Government had decided to restrict the entry into the Ontario investment community of non-Canadian residents¹. More recently, in a broader context, in restating "An Economic Strategy for Ontario", he made this further general comment:

First, it would be a serious misinterpretation for anyone to equate my government's attitude with anti-Americanism, or with any form of alienation toward any other country. To control one's own economic destiny is not to refuse to live, trade or compete with one's neighbours. To seek the capacity to plan our economic future, on our own terms, is not to suggest that technology, capital and labour are unwelcome from any source. But, the economic symphony which we created must be conducted for and by Canadians².

The immediate controls were established through regulations to The Securities Act³.

The Establishment of the Study

1.02 This Study Committee was established in response to the Premier's request⁴. We were requested to study and to make recommendations on specific aspects of

-
1. Legislature of Ontario, Debates, July 13th, 28th Legislature, 4th Session, p. 3868.
 2. Address to the Windsor Chamber of Commerce, Windsor, Ontario, Friday, January 21, 1972.
 3. Regulation 794 made under The Securities Act, R.R.O. 1970 as amended by O. Regs. 296/71 and 337/71.
 4. Bulletin of the Ontario Securities Commission, August, 1971, pp. 95-97.

two broad issues. The first of these was whether Ontario registrants should be permitted to raise additional capital from the public⁵. The second question was what additional restrictions, if any, should be placed on non-Canadian resident ownership and capital of Ontario securities firms⁶. While in one regard it may be suggested that the Premier's July 13th statement determined the position so far as new entrants into the business were concerned we have examined these questions broadly in the light of the facts and submissions placed before us.

Outside Investment in Securities Firms: Today

1.03 Apart from loans from established lending institutions the securities firms whose head offices are in Canada largely have been restricted in their access to new capital to the funds provided by their proprietors, partners, shareholders (including directors) and officers. There has been a growing concern that these sources are insufficient to provide the additional capital necessary to permit firms to perform the several functions necessary for them to further Canadian economic development. This leads to a consideration of the need to seek capital from the public.

The Demands for Additional Capital

1.04 The pressures for additional capital arise in almost contradictory manners. During the period of very high volume trading which extended into 1969 a number of firms found themselves hard pressed to meet the expanded

5. The classes of registrants are detailed at par. 4.04 of this Report.

6. See the terms of reference established for the Study Committee, Bulletin of the Ontario Securities Commission, August, 1971, as reproduced at page vi of this Report.

capital demands which this increased business placed on them. During the low volume period which followed they found themselves with surplus capacity and fixed charges created by expanded staff, accommodation and facilities, which now were a financial drain . Change is costly: there has been substantial change. Trading and accounting facilities are increasingly mechanized and computerized. Competition demands greater research facilities to service clients. The "institutional investors" demand special treatment and look elsewhere for it if it is not available . Commissions are negotiable on trades involving \$500,000 or more with the changes in the United States bringing pressure for further reduction in Canada. The commission rate structure of the Toronto Stock Exchange and other Canadian exchanges is being carefully examined to the end that they will remain competitive and viable. To facilitate the trading in Canada of large blocks, and in particular to provide liquidity for the accounts of major clients within the framework of the existing exchange auction

7. See infra at paras. 4.26-4.41 for a financial profile of registrants which shows changes in income and expenses.

8. For the purpose of this Report, the term "institutional investors" includes banks, loan and trust companies, mutual funds, pension plans, credit unions, finance and acceptance companies, and investment corporations. In the United States the SEC Policy Statement "Future Structure of the Securities Markets", February 4th, 1972 (CCH #409, pp. 44-45) provides the following definition: "The term 'institutional membership' has not been clearly defined with the result that discussion of this issue, both in terms of public policy and in terms of where responsibility for deciding the fundamental question is lodged, has been enveloped in a definitional fog. For this purpose, we define institutions to include banks, pension and other employee benefit funds, investment companies (including their advisors) and insurance companies."

9. See para. 41.19 infra, "Activities of Non-Ontario Registrants".

market, so-called "liability trading" is permitted¹⁰.

This enables a broker-agent to change his role when the auction market is not able to assimilate immediately the whole of his client's large block of securities. The rule permits the broker, with suitable safeguards, to purchase part of the block for his own account to complete the sale. These are but a few of the matters which engaged the Committee's attention. Each of them imposed some demand for new or expanded sources of capital.

Availability of Capital: The Public

1.05 In 1.03 we noted that Canadian investment firms have for the most part generated new capital internally. For some time there has been a respectable body of opinion in the United States that securities firms should be permitted to seek capital for their operations from the public generally. Assuming such an investment to be attractive to the public this outside source of capital would not only enable a firm to meet the immediate requirements for expanded service and sophisticated technology but would also permit the expansion of the firm. The National Association of Securities Dealers in the United States permits public ownership of its members. A number of the U.S. regional stock exchanges and, in July, 1970, the New York Stock Exchange, have permitted public ownership for their members within certain limits. In Canada the Moore Committee¹¹

10. The Toronto Stock Exchange, Bylaws, sections 11.67 and 11.68.

11. Report of the Committee to Study the Requirements and Sources of Capital and the Implications of Non-Resident Capital for the Canadian Securities Industry, May, 1970. The Report was commissioned jointly by the Investment Dealers' Association of Canada and the Canadian, Montreal, Toronto and Vancouver Stock Exchanges. It was chaired by Mr. Trevor H. Moore, and so is frequently termed the "Moore Report".

representing all of the major Canadian self-regulatory bodies, concluded that securities firms should have limited access to outside sources of capital. This background suggested three areas of careful study before recommendations for new policy and legislation could be made. These were the need for capital, the available sources of capital, and the safeguards necessary to protect the public.

The Function of the Securities Industry

1.06 The securities industry has a number of roles. It raises and provides capital for the development of natural resources and the establishment and expansion of secondary and service industries. It facilitates the purchase and sale of already issued securities, providing a stable and ready market place for them, thereby encouraging the public to invest its money in the securities of public companies. Through both kinds of activities it facilitates the movement of savings of both individuals and institutional investors. In this study we were interested in all classes of registrants authorized under The Securities Act to deal with the public: dealers as well as advisers, agents as well as principals. Collectively the registrants and the institutional investors constitute a financial community which provides the facilities and creates the economic climate in which the public of Ontario invest their savings. Within the limits of the legislative scheme then in force they direct public savings to the use they deem appropriate.

Non-Resident Ownership

1.07 Residence rather than citizenship has been adopted as a realistic criterion. But in this context we must be careful to distinguish between the ownership of

Canadian primary resources and industry and the ownership and control of Canadian financial institutions and, in particular, securities firms. Prior to World War I much of our capital and managerial and economic expertise came from the United Kingdom. More recently our economy has been dominated by the United States¹². Today Canadian governments at all levels as well as industry have sought capital from Europe and the United States. They have been assisted by foreign financial institutions. In a securities context a number of foreign based firms established branch office operations in Ontario¹³. The take-over of an established, Canadian owned dealer by a major United States securities firm in 1969 gave impetus to a growing concern about the extent of non-resident ownership of the Canadian economy in general and key sectors in particular.

The Securities Industry: A Key Sector of the Economy

1.08 In July, 1971 Premier Davis confirmed his Government's belief that the securities industry is a key sector of the Ontario and Canadian economy¹⁴. In the regulation which was passed immediately non-resident ownership of new registrants was restricted to a maximum of 25%, with no one person or associated group of non-residents permitted to hold more than 10%. Existing non-resident controlled firms, generally speaking, were exempted from the new requirements but any material changes in their non-resident shareholders or any attempt to take-over any existing Canadian resident

12. See the Report of the Interdepartmental Task Force on Foreign Investment, Ontario, Department of Treasury and Economics, Trade and Development and Financial and Commercial Affairs, 1971.

13. See Appendix "D".

14. Supra, footnote 1.

owned firm would result in the application of the new restrictions¹⁵. The formula followed Ontario precedent in dealing with key sectors¹⁶.

Problems: Existing Non-Resident Ownership

1.09 The Premier's statement and the regulations adopted established for at least an interim period limits on non-resident ownership for new registrants and on material changes in non-resident ownership for existing registrants. For existing registrants whose non-resident ownership exceeded these limits three major questions remained. Firstly, should the non-resident be required to reduce or "roll back" the amount of capital it had in the firm either through withdrawal of capital or distribution of its securities to Canadians and, if so, what formula should be applied. Secondly, should the non-resident owners be permitted to provide additional capital through loans or by guarantee of loans. Thirdly, should non-resident owned firms be permitted access, directly or indirectly, to capital obtained in a manner significantly different from that permitted to other Ontario registrants.

1.10 While the study stemmed from questions of foreign or non-resident ownership this led inevitably to the second major topic: public ownership. For the most part the two topics, non-resident and public ownership, will be dealt with separately. An overlap occurs where the non-resident owned parent of an

15. Supra, footnote 3.

16. The Loan and Trust Corporations Act, R.S.O. 1970, c. 254, and The Paperback and Periodical Distributors Act, 1971, S.O. 1971, c.82.

Ontario registrant¹⁷ or a non-resident owned firm with an Ontario branch office¹⁸ offers its securities to the public.

The Study: Its Mechanics

1.11 Once constituted the Committee agreed upon and published a list of questions to which it wished to direct its attention¹⁹. We invited written submissions. To provide an atmosphere of complete candour we accepted replies on a confidential or for publication basis. Written submissions were received from twenty-six persons, firms and organizations. Only two requested that their briefs be kept confidential. The remaining twenty-four are listed in Appendix "A". Copies of their briefs will form part of the public material which will be assembled and filed in the departmental library following the submission of this Report.

1.12 A confidential financial questionnaire was designed by an interdepartmental committee formed for this purpose²⁰. They sought the advice of those who prepared the confidential questionnaire used in connection with the Moore Study. The questionnaire, the letter of transmittal

17. For example Merrill Lynch, Pierce, Fenner and Smith, Incorporated and Merrill Lynch, Royal Securities Limited.

18. For example Bache and Company, Incorporated.

19. See the Bulletin of the Ontario Securities Commission, September, 1971.

20. This Committee included Mrs. D. Stafl, Departmental Economist, Department of Financial and Commercial Affairs, Mrs. H. Salisbury, Economist, Department of Treasury and Economics, Mr. S. Gorecki, C.A., Financial Analyst, Ontario Securities Commission, Mr. R.T. Cooper, Director, Research Branch, Department of Trade and Development, Mr. D.L. Johnston, Counsel to the Study.

and some additional explanation given to all Ontario principal registrants will be found in Appendix "B". A list of Ontario registrants to whom the questionnaire was directed will be found as Appendix "C". Appendix "D" is a list of non-resident controlled firms. Appendix "E" is a list of the Bank of Canada recognized money market dealers.

1.13 The questionnaire was sent to 223 registrants on October 8th, 1971. Although there were some unavoidable delays returns were received from all but twenty of the registrants holding registration on January 31st, 1972. This, to the best of our knowledge, is the first time that any branch of government in Canada has obtained data permitting an analysis of the industry's past performance with a view to estimating its future needs. While the individual questionnaire responses must remain confidential, specific cumulative results are referred to and relied upon in this Report. Other important financial information has been collected and forms the Schedules found in Appendix "F".

Public hearings were held on four days for the purpose of receiving additional submissions as well as oral submissions concerning the written briefs. Transcripts of these proceedings will also form part of the public record. A list of those appearing either in person or through counsel will be found in Appendix "G".

The Committee, and in particular its Counsel, studied and within the time available analyzed a vast body of what may be styled general research material. A bibliography of what appeared to be the most relevant of the published material examined is assembled in Appendix "H".

Underlying Objectives of the Study

1.14 As Premier Davis noted, the Canadian investment community assumes responsibility for the direction of vast sums of capital. A large portion of these funds represent the savings of individual Canadians. It is important that the investment community be responsible and responsive to the particular needs of Canada. The owners of investment firms must be amenable to these needs and aspirations. It is therefore essential that ownership remain substantially in the control of Canadian residents who are patently more receptive to these needs and aspirations. As securities administrators our recommendations should be consistent with the traditional purpose of securities regulation: ensuring that the investor is dealt with fairly under conditions which will inspire and maintain continued confidence in Canadian capital markets. To this end the industry must have access to adequate sources of new capital to meet the demands placed on it. While the industry should remain substantially Canadian owned and not become foreign dominated, the regulations recommended must encourage competition and reward efficiency. It is implicit in this Report as it is explicit in Ontario's securities law that self-regulation remains important²¹. The Committee views with approbation the continuing efforts of the self-regulatory bodies to maintain standards for their members which, while in the broad public interest, are not necessary to the immediate private interest of the individual member.

21. In this regard see The Securities Act, sections 58(2) (b) and (c), 140, 6, 30 and 31, and section 2 of Regulation 794.

Contents of the Report

1.15 In Chapter II we shall deal briefly with several recent economic studies and reports which have been concerned with foreign ownership and the securities industry. In Chapter III we shall move on to a broad consideration of Canadian capital requirements and consider existing data regarding the availability of savings for investment. An exploration of the capital requirements of both the public and private sectors of the economy will be attempted. In this macro-economic context consideration will be given to the movement of domestic savings within Canada and out of the country as well as the reliance on and the encouragement offered to non-resident capital to move into Canada. A special concern will be pointed out respecting capital movements out of Canada through institutional investors. Chapter IV will focus on the Canadian securities industry - its history, functions, ownership and capital structure - with a view to isolating problems and indicating the objectives toward which we feel the industry should strive through the 1970's in order to better serve the Canadian economy. It reaches conclusions as to the need for capital. Based on these conclusions we move in Chapter V to a consideration of the spectrum of alternatives ranging from internal ownership to broad based public ownership. Chapter IV also will provide a base for Chapter VI in which the question of non-resident ownership is examined. Chapter VI will conclude with recommendations concerning limitations on new capital in non-resident owned firms and our conclusions concerning compulsory roll-back of non-resident ownership. Chapter VII is a summary of the conclusions and recommendations in the Report.

RELATED STUDIES AND REPORTS

Studies

2.01 The past fifteen years have been marked by more than that number of reports and studies dealing in whole or in part with the kinds of questions which have engaged our attention¹. The Report of the Royal Commission on Canada's Economic Prospects² published in 1957 (Gordon Report) set out some projections on available savings and the need for capital in the medium term. The Royal Commission on Banking and Finance³ which reported in 1964 (Porter Report) was particularly concerned with the financial community and suggested specific reforms. The latter Report called for greater diversity and innovation in the securities industry and called for practices leading to increased competition⁴. Two subsequent Ontario reports were concerned with questions of more adequate and continuing disclosure for security issuers⁵. In our present context the philosophy of continuous disclosure underlines the necessity for sophisticated research and analysis of

1. See Appendix "H".

2. Royal Commission on Canada's Economic Prospects, Final Report, Ottawa, Queen's Printer for Canada, 1957 (Gordon Report).

3. Royal Commission on Banking and Finance, Report, Ottawa, Queen's Printer for Canada, 1964 (Porter Commission).

4. Supra, footnote 3, Chapters 16 and 17.

5. Report of the Attorney-General's Committee on Securities Legislation in Ontario, Toronto, Queen's Printer, 1965 (Kimber Report) and Ontario, Department of Financial and Commercial Affairs, Report of the Committee of the Ontario Securities Commission on the Problems of Disclosure Raised for Investors by Business Combinations and Private Placements, 1970 (Merger Report).

this information by registrants for the benefit of their clients. In short, fuller disclosure places greater demands on registrants.

The Moore Committee: The Joint Industry Committee

2.02 In May, 1969, the largest brokerage house in the United States, Merrill Lynch, Pierce, Fenner & Smith Inc., acquired control of an old well established Canadian investment dealer, Royal Securities Corporation Limited. Such was the concern of a substantial part of the Canadian investment community that a national seven man committee was immediately formed by the Investment Dealers' Association of Canada and the Canadian, Montreal, Toronto and Vancouver Stock Exchanges, to study the requirements and sources of capital and the implications of non-resident capital for the Canadian securities industry. The Moore Committee reported in May, 1970. Shortly after the publication of its Report a second Committee, known as the Joint Industry Committee, was formed by the sponsoring organizations to review and make recommendations regarding the implementation and possible modification of the Moore recommendations. The comments of the Joint Committee were released in late July, 1971⁶.

Joint Industry Committee Recommendations

2.03 On the issue of non-resident ownership the Committee recommended a formula through which existing non-resident ownership would be reduced by a compulsory roll back to 25% by 1986. Limits would be placed on non-resident ownership for new registrants. Take-overs of existing registrants by foreigners would be effectively prohibited.

6. Report of the Joint Industry Committee Studying the Moore Report, July, 1971.

Dealing with sources of new capital, it agreed that new sources of capital were required by Canadian firms. However it rejected the concept of broad public ownership. It would permit investment by approved "non-industry" investors. A maximum of 25% of the participating or voting securities could be held by such investors with no single outside investor holding more than 10% of such securities. In addition to loans from approved lending institutions firms could issue debt securities to approved investors. Firms would be permitted to increase their existing capital by two-thirds from such outside sources. (Thus a firm whose existing capital was \$3,000,000 would be permitted to raise an additional \$2,000,000 through the sale of debt or equity securities to approved outside investors.) There would continue to be no restriction on inside investment, of course. The implementation of these recommendations has been suspended pending the completion of this Report.

Study of the Securities Industry in Quebec

2.04 On August 24th, 1971, the Committee appointed in June, 1970, by the Quebec Minister of Financial Institutions, Companies and Co-Operatives to study the implications for Quebec of the Moore Report recommendations published an Interim Report⁷. The declared objective of the Committee was to foster the development of a strong Quebec based securities community to provide the Quebec based firms not only with a leading position in Quebec but a greater proportion of Canadian and international under-

7. Quebec, Department of Financial Institutions, Companies and Co-Operatives, Study on the Securities Industry in Quebec, Interim Report. The report is known by the name of its chairman, Ls-Phillippe Bouchard, Q.C., Deputy-Minister of the Department.

writing and securities markets. Their conclusions concerning the admission of foreign firms are opposite to those of the Moore Report. They also recommend that Quebec securities firms have the easiest access possible to permanent capital, short or long term. Within limits to be set by the Quebec Securities Commission, non-Canadian owned firms would be welcomed in Quebec. The purpose is to lessen Quebec's dependence in the raising of the capital it requires on non-Quebec Canadian firms, the majority of whose head offices are in Toronto. This is an interim report. The rationale for the recommendations no doubt will be more clearly apparent when the final report is published. Certainly one cannot quarrel with its proper provincial aspirations and, in particular, its desire to strengthen the position of Quebec dealers.

Report of the Ontario Interdepartmental Task Force on Foreign Investment

2.05 Implicit in the consideration of the securities industry is the broad question as to how well the industry has served the economy. Two major elements in that economy are the pools of savings available and the demand for investment capital. The task is to determine how well each is serving the other and the ease and efficiency with which the necessary redirection of funds occurs. An Ontario Interdepartmental Task Force was formed late in 1970 and reported in November, 1971⁸. It was chaired by Mr. C.P. Honey of the Department of Treasury and Economics. Two of his group, Mrs. D.A. Stafl and Mr. S.S. Gorecki, C.A. were key figures in our study team.

8. Op. cit., Ch. I, footnote 12.

2.06 The Task Force undertook a study of the national and provincial aspects of the foreign investment question. It proposed policy alternatives which are presently being considered by a Select Committee on Economic and Cultural Nationalism appointed by Premier Davis⁹. In the preparation of the Task Force Report useful historical and current statistical information and projections were assembled. They provide a valuable examination of the savings and investment sectors of the economy and offer a basis from which conclusions regarding the extent of necessary reliance on foreign capital may be drawn. That Report recommends a philosophy of moderate Canadian nationalism rather than a completely "open door" policy. The conclusions are drawn in the Canadian as well as Ontario context.

The Unofficial Gray Report

2.07 The Task Force on the Structure of Canadian Industry published its Report in 1968¹⁰. It called for the establishment of a special governmental agency to supervise the operation of foreign-owned companies in Canada. In 1970 the Special Committee Respecting Canada - U.S. Relations issued a report focusing additional attention on the question of foreign ownership¹¹. More recently there has been public conjecture about the contents of a

9. Ontario, Select Committee on Economic and Cultural Nationalism, Preliminary Report, March, 1972.

10. Task Force on the Structure of Canadian Industry, Foreign Ownership and the Structure of Canadian Industry, Ottawa, Queen's Printer for Canada, 1968 (Watkins Report).

11. Canada, House of Commons, Standing Committee on External Affairs and National Defence, Special Committee Respecting Canada - U.S. Relations, Report, No. 33, July, 1970 (Wahn Report).

report prepared by a task force headed by The Honourable Herbert Gray¹². The report has not been released and the most recent indications (April 21, 1972) are that it may not be for some time to come. We must therefore be content with the unofficial draft entitled, "Domestic Control of the National Environment - The Problems of Foreign Ownership Control", published by The Canadian Forum in December, 1971¹³.

2.08 It is not an unwarranted conclusion that the unofficial draft, as published, accurately reflects the views of the Gray Task Force. It states that "the high growing degree of foreign and particularly U.S. control of Canadian business activity has led to a Canadian industrial structure which largely reflects the growth priorities of foreign corporations."¹⁴ It offered the three following policy alternatives for dealing with the problem: first, a screening process which would be "a government agency with power to negotiate for better performance from foreign investors, and with the power to block investment that did not make a net contribution to the Canadian economy or did not accord with the objectives of the Government"¹⁵; second, "the delineation of further key sectors in which foreign ownership would be regulated"¹⁶; and third, "the introduction of across-the-board ownership

12. At the time Mr. Gray was requested to commence the study he was Minister without Portfolio. At the time the unofficial draft was published, and currently, he is Minister of National Revenue.

13. The Canadian Forum, December, 1971, Vol. LI, No. 611.

14. Ibid, p. 1.

15. Ibid.

16. Ibid.

rules (e.g. 51% Canadian ownership) and other structural changes relating to the use of Canadian managers and directors"¹⁷. The Report recommended the first of these alternatives as the most effective and the least expensive method of treating the problem¹⁸.

United States Studies

2.09 There have been a number of studies conducted in the United States, including Congressional Hearings presently in progress, which bear on the topics of public ownership and competition. The National Association of Securities Dealers (NASD), a national recognized self-regulatory body, concluded some years ago that public ownership was not contrary to the public interest. More recent pronouncements of the Securities and Exchange Commission (SEC), in dealing with questions of public ownership of New York Stock Exchange (NYSE) members concur in this view. In July, 1970 the NYSE sanctioned public ownership of its member firms¹⁹. Both the NASD and the NYSE provide specific conditions and safeguards before permitting a member to "go public"

2.10 The pressure to permit United States firms to obtain capital from the public has resulted from positive developments as well as outside pressures. The administrative or "back office" problems of many firms and the resulting difficulties in recent years are well documented. This has been partially alleviated in New York through the development of a Central Certificate Service within the New York Clearing Corporation, currently covering securities

17. Ibid.

18. Ibid.

19. See generally, The Constitution and Rules of the New York Stock Exchange.

listed on the New York and American Stock Exchanges. It is proposed to include stocks traded over the counter. The system includes a licensing or screening standard for all employees.

2.11 The Institutional Investor Study²⁰, prepared by the SEC and released in March, 1971, explored in depth the growth of institutional investors and made recommendations for legislation. The Report of Mr. William McChesney Martin delivered in August, 1971, to the NYSE concerns the future role of the exchange and recommends the establishment of a central stock exchange²¹. It is a document of current and important debate. The success of the NASD's automated quotation system gives impetus to the debate. More recently the SEC has come down in favour of a central market place²².

2.12 The SEC is presently assisting two Congressional Committee hearings: one under the Chairmanship of Senator Harrison H. Williams and the other chaired by Representative John E. Moss. Both studies are concerned with the future of the securities industry.

2.13 The U.S. problem regarding brokerage failures resulted in the federal government sponsored Security Industry Contingency Insurance Fund. More recently the

20. United States, Securities and Exchange Commission, Institutional Investor Study Report, U.S. Government Printing Office,, Washington, 1971.

21. "A Report, with Recommendations" by William McChesney Martin, Jr., submitted to The Board of Governors of the New York Stock Exchange, August 5, 1971.

22. United States, Securities and Exchange Commission, Future Structure of the Securities Markets, February 4, 1972.

SEC has requested greater control over the industry self-regulatory bodies²³. These reports, studies, and changes accentuate the similarities and differences of the Canadian industry. They continue to provide important information and analysis on matters of mutual concern. The market place is international and it would be insular to fail to consider the impact of the United States problems and their solutions in Ontario and throughout Canada.

23. In Ontario these controls are already in existence through The Securities Act and Regulations made thereunder.

CHAPTER III

CANADIAN CAPITAL REQUIREMENTS^{*}

Introduction

3.01 The objective of this chapter is to make a brief survey of past Canadian capital requirements and then forecast capital needs of the Canadian economy over the medium term future. By this we mean the next five to ten years. This will provide a background within which to focus on the functions and goals of the Canadian securities industry in meeting Canadian economic needs over the same medium term.

The Canadian Economy

3.02 A nation's aspiration is to achieve the highest degree of utilization of national wealth in an effort to achieve the goals set by its people. Canada is endowed with rich natural resources and an educated and skilled labour force. As a young, energetic, developing country it has been dependent on foreign capital to meet these objectives. Its economic environment has been conducive to foreign investment.

Historically an exporting nation, our economy has always been closely linked to and affected by the international economic climate. This is illustrated by Canada's current trade discussions with the United States. Yet in this time of growing global economic interdependence, with many nations making increasing demands on the international capital market to finance their economic development, there is a strong desire for self-determination among nations¹. This phenomenon is present in Canada no

1. See Chapter II, supra.

less than in many other parts of the world.

Future Canadian Capital Requirements

3.03 The Economic Council of Canada (ECC) stated that volume of total output will have to expand by 50% for 1967 - 1975 in order to sustain satisfactory economic growth and to absorb the unusually high influx of workers into the labour force. This growth would require expenditures in new plants and equipment to increase by 5.8% annually. These are much higher rates than Canada has been able to sustain in the past. As new techniques and processes are introduced into production the need to maintain and increase our competitiveness in world markets will require not simply replacement of depreciating equipment but the substitution of more advanced and sophisticated, and consequently more costly, capital assets. Additional demands come from environmental controls. Inflationary pressures push the need for capital higher. Demands for housing, social and public services continue to accelerate. The capital requirements of the private and public sectors are ready to absorb a larger portion of the gross savings than they have received in past decades.

Source and Application of Gross Savings: 1967 - 1971 and Savings and Investment Projections: 1975

3.04 Whether and how Canadian capital requirements can be satisfied depends on available savings. Some observations as to available savings in the future can be made by examining past sources and disposition of domestic savings and then projecting forward to anticipated savings and their investment application. Table 1 supplies actual figures for the period 1967 to 1971.

Table 1. Sources of Gross Saving

	Per- sonal Saving	Undistributed Profits Corporate	Gov't Gov't	Gov't Saving	Non- Res. Saving	C.C.A.*	Total**
		millions of		dollars			
1967	3,223	2,462	196	2,412	615	7,877	16,312
1968	3,339	2,706	255	3,030	268	8,411	17,161
1969	3,485	2,813	286	4,183	960	9,066	19,316
1970	4,182	2,434	310	3,327	-1,115	9,898	18,535
1971	5,163	3,265	331	3,378	-12	10,531	21,182

* Capital Consumption Allowances also called Depreciation Allowances.

** Includes inventory valuation adjustments and residual error of estimate.

Table 1. Disposition of Gross Saving

	Gross Fixed Capital Formation		
	Private	Gov't	Total *
	millions of dollars		
1967	12,715	2,969	16,312
1968	12,814	2,995	17,161
1969	14,190	3,052	19,316
1970	14,709	3,252	18,535
1971	16,207	3,779	21,182

* Includes inventory valuation adjustments and residual error of estimate.

Source: Statistics Canada, National Income and Expenditure Accounts, Catalogue 13-001, Tables 2, 18 and 19.

Table 2 gives projections of growth savings and of capital requirements.

Table 2. Saving and Investment Projection

	Saving					Investment			
	Domestic			Exter-					
	Pers.	Corp.	Gov't	-nal	Total	Bus.	Resd'l	Gov't	Total
	billions of					dollars			
1975 A	4.1	18.1	6.5	1.5	30.2	19.0	5.2	6.0	30.2
B	4.7	17.6	6.1	2.4	30.8	18.8	5.9	6.1	30.8

Sources: A - Economic Council of Canada, Sixth Annual Review, Chapter 6.

B - Canadian Life Insurance Association, Submission on the Proposals for Tax Reform in the White Paper of the Government of Canada.

The most important observations that develop from Tables 1 and 2 are the following:

1. The availability of personal savings is expected to lessen between 1971 and 1975.
2. Government savings, presumably with less flexibility in disposition, and Government disposition of savings will increase substantially from 1971 to 1975.
3. The largest source of funds for business has been and will be capital consumption allowances, also called depreciation allowable for tax purposes. These allowances do not result in additional capital formation. Furthermore since they change very gradually in relation to gross national product the other sources of capital must grow to meet the demand of accelerated economic expansion.
4. External savings will be required to supplement domestic savings. Precisely how much is difficult to pinpoint. The two projections show substantial variation between \$1.5 and 2.4 billion.

Financing the Economic Growth Objectives - Dependence on Foreign Capital

3.05 Tables 1 and 2 indicate Canada will continue to depend on a significant amount of foreign capital to meet its capital requirements through 1975. What can be learned about this foreign capital by analysing past patterns and considering projections? First, in the past Canadians have placed substantial dependence on foreign capital in spite of the fact that Canadians have maintained one of the world's highest rates of personal savings in relation to gross national product (GNP)². These private savings have

2. ECC Sixth Annual Review, Perspective 1975, Queen's Printer, Canada, 1969, p. 102.

averaged 18¹/₂% of GNP in the post war years³. This is borne out in the following two tables:

Table 3. Use of Foreign and Domestic Resources in Gross Capital Formation in Canada, 1946-69⁴.

	<u>Gross Capital Formation</u>	<u>Net Use of Domestic Resources</u> billions of dollars	<u>Net Use of Foreign Resources</u>
1946	1.8	2.0	-0.2
1955	6.6	5.0	1.6
1960	8.9	6.4	2.4
1961	8.4	6.3	2.2
1962	9.7	7.6	2.2
1963	10.4	8.5	2.0
1964	11.8	9.9	2.0
1965	14.6	11.6	3.0
1966	16.7	13.7	3.0
1967	16.3	13.6	2.7
1968P	17.2	14.8	2.3
1969P	19.3	16.0	3.3

Source: Statistics Canada: Canada's International Investment Position 1926 to 1967, Catalogue 67-202 Annual. Statement 29, p. 62.

Table 4. Use of Foreign Resources 1946-69

	<u>Gross Capital Formation</u>			<u>Net Capital Formation</u>		
	<u>Gross foreign savings</u>	<u>Gross nat'l savings</u>	<u>As % of total</u>	<u>Net foreign savings</u>	<u>Net nat'l savings</u>	<u>As % of total</u>
	billions of dollars			billions of dollars		
1946-49	-0.1	10.6	-1	-0.7	5.0	-14
1950-52	1.9	15.2	13	1.2	8.4	14
1953-55	3.8	18.1	21	2.6	8.5	30
1956-58	6.9	25.6	27	5.0	12.9	39
1959-61	7.2	26.3	27	4.8	11.4	42
1962-64	6.1	32.0	19	3.1	14.1	22
1965-67	8.6	47.6	18	5.2	25.5	21
1968-69P	5.6	36.5	16	3.0	19.0	16
1946-69	40.0	211.8	19	24.2	104.7	23

Source: Statistics Canada: Canada's International Investment Position 1926 to 1967, Catalogue 67-202 Annual. Statement 30, p. 63.

3. Ibid.

4. Statistics Canada, Canada's International Investment Position 1926 to 1967, Catalogue 67-202, pp. 58-59. It is necessary to explain in particular the measure of "Use of Foreign Resources" as used in Tables 3 and

With the exception of the immediate post-war period foreign resources were used to supplement domestic savings in capital formation in Canada. Capital expenditures for exploration of natural resources absorbed a larger portion of foreign capital, particularly during the 1950's. The dependence on foreign capital declined from 27% of gross capital formation in the 1956 - 1961 period to about 16% in 1968 - 1969. The preliminary estimates for 1970 indicate that sufficient domestic savings were generated to reduce the reliance on foreign capital even further. Even if reliance on new foreign capital diminishes, however, the present extent of foreign long-term investment in Canada is substantial. The drain on domestic savings to service and repay foreign investment will accelerate.

4. cont'd

4. The Gross Measure, as used in "Gross foreign savings" in Table 4, includes:

"Current account surplus or deficit adjusted for undistributed earnings of Canadian direct investment abroad, plus capital consumption allowances and depletion allowances allocated to foreign direct investment in Canada".

The Net Measure, as used in "Net foreign savings" in Table 4, includes:

"Current account surplus or deficit adjusted for undistributed earnings of foreign direct investment in Canada and undistributed earnings of Canadian direct investment abroad, as above, but excluding capital consumption allowances allocated to foreign direct investment in Canada."

Tables 3 and 4 illustrate a new approach developed by Statistics Canada in measuring the extent of the role played by foreign capital in financing Canadian capital formation. The figures as shown in Table 1 use current account surplus or deficit for non-resident saving. They do not measure the full earnings of foreign investments and do not include earnings of Canadians abroad.

Table 5. Foreign Long-Term Investment in Canada⁵

	<u>1945</u>	<u>1960</u>	<u>1967</u>
	billions of dollars		
Direct Investments	2,713	12,872	20,699
Portfolio Investments	4,095	7,914	11,572
Miscellaneous Investments	<u>284</u>	<u>1,428</u>	<u>2,431</u>
Total	7,092	22,214	34,702

Growth of Foreign Portfolio Investment v. Direct Investment

3.06 Between 1926 and 1967 the ratio of foreign direct investment to portfolio investment increased from one-third to two-thirds⁶. There were many reasons why the foreign investor increasingly desired to control the Canadian enterprise. Vast amounts of capital were invested in the exploration and development of natural resources. Branch plants were established to avoid tariff barriers. Foreign controlled companies, often with a higher ratio of profitability (in some cases because research and development was charged to the parent)

5. Ibid, p. 26. The distinction between direct and portfolio investment is explained as follows:

"Non-resident long-term investment in Canada may be classified into two main groups - direct and portfolio investments, based chiefly on the nature of the ownership. Direct investment is that investment in a business enterprise which is sufficiently concentrated to constitute control. The nature of the classification is such that potential control is implied rather than an actual exercise of control over business policy, although the latter is usually present. Direct investment is usually related to equity ownership... Direct investment usually involves a package which in addition to capital may also include such factors as burden of risk, technology, management know-how, other economies of scale and market access.

Portfolio investments on the other hand are typically scattered minority holdings of marketable securities which do not carry with them control of the enterprises in which the investments occur".

6. Ibid, p. 44.

retained these earnings and thus accelerated the direct investment. Many domestic companies were purchased or taken over by foreign companies.

Geographical Sources of Foreign Capital

3.07 It is important to examine the geographical sources of foreign capital.

Table 6. Sources of Foreign Capital⁷

<u>Year 1967</u>	<u>U.S.</u>	<u>U.K.</u>	<u>All Other</u>	<u>Total</u>
	millions of dollars			
Direct Investments	17,000	2,152	1,547	20,699
Portfolio Investments	9,440	1,233	899	11,572
Miscellaneous Investments	<u>1,590</u>	<u>191</u>	<u>650</u>	<u>2,431</u>
Total	28,030	3,576	3,096	34,702

The United States has been the largest outside contributor of capital in the post-war period. In addition to the more obvious reasons for this such as geography and the U.S. need for Canada's natural resources, for some years Canada has enjoyed preferred access to the U.S. financial market. New Canadian issues were exempted from the U.S. Interest Equalization Tax imposed in July, 1963. Canada was exempted from the restrictions upon direct investment abroad imposed upon U.S. firms by their government in March, 1968. When these exemptions were granted, Canada was running a substantial balance of trade deficit with the U.S. This deficit shifted until in 1970 we showed a balance of trade surplus. When in August, 1971 the U.S. imposed the 10% surcharge on imports Canada was not exempted. It is reasonable to conclude that the amount of capital available from the United States will not be as readily

7. Ibid, pp. 108-111.

available in future years. The retention and repatriation of capital implicit in the Domestic Investment Sales Corporation (DISC) is an illustration. Capital from Europe and Japan may in some measure serve as a replacement.

3.08 In general terms it is clear that the Canadian provinces do not intend to discourage further foreign capital investments, subject to limited "key sector" restrictions in some provinces⁸. Federal policy will be announced, or at least indicated, with the publication of the official Gray Report. The federal government has already adopted a "key sector" approach⁹.

Financing the Economic Growth Objectives - Domestic Savings

3.09 The urgent demand for capital required to finance Canadian economic growth objectives is occurring at a time when the shortage of capital on a world-wide basis is intensifying. An increasingly efficient utilization and allocation of funds will be necessary to meet capital needs and priorities. The source and aggregate level of

8. See the Report of the Interdepartmental Task Force on Foreign Investment, op. cit., Ch. I, footnote 12, and the Interim Report of the Select Committee on Economic and Cultural Nationalism, op. cit., Ch. II, footnote 9.

9. Legislation illustrating the concern regarding ownership of certain sectors in the Canadian economy includes:

Bank Act, R.S.C. 1970, c. B-1.

Broadcasting Act, R.S.C. 1970, c. B-11 and Order-in-Council P.C. 1969-2229.

Canadian and British Insurance Companies Act, R.S.C. 1970, c. I-15.

Income Tax Act, S.C. 1970-71, c. 63.

Loan Companies Act, R.S.C. 1970, c. L-12.

Trust Companies Act, R.S.C. 1970, c. T-16.

Regulations made under the Territorial Lands Act, R.S.C. 1970, c. T-6 and the Public Land Grants Act, R.S.C. 1970, c. P-29, being regulations pertaining to Canadian Gas and Oil Land, S.O.R./61-253.

savings available in Canada is expected to change significantly. As the demand for capital grows, the supply of domestic savings is expected to decline in relative terms as anticipated in ECC projections shown in Table 2. Several indicators point to this trend. In the 1970's there will be a large entry into the 19-34 and the 65-and-over age groups. The middle-aged group, traditionally the major source of savings, will decline in proportion to the other two groups. The 19-34 age is one of growing spending while the increasing pension payments for the 65-and-over group reduce the overall rate of personal savings. The decline will be counteracted (but not completely offset) by the increasing participation of the 19-34 group in pension funds, life insurance and mutual funds. The importance of savings managed by institutional investors can then scarcely be overemphasized.

Institutional Savings Pools

3.10 The long term commitments of the institutional investor turn on the objectives of its management - growth versus income, risk versus yield. The following table demonstrates the importance of institutional savings and that a portion of these savings generated in Canada have been directed to foreign markets. This portion is particularly significant in the case of mutual funds.

Table 7. Financial Institutions¹⁰

	1965	1966	1967 millions	1968 of dollars	1969	1970	% changes in 65-70 period
<u>Life Insurance Cos.</u>							
Total Assets (at cost)	11,424	12,127	12,912	13,667	14,334	14,960	32.3
Foreign: Bonds	163	184	250	269	300	188	
Stocks	89	94	88	38	83	83	
<u>Trusteed Pension Funds</u>							
Total Assets (at cost)	6,541	7,250	8,068	8,972	10,003	11,059	69.0
Foreign: Bonds	4	9	10	12	16	12	
Stocks	169	235	333	509	634	592	
<u>Mutual Funds</u>							
Total Assets (at cost)	1,574	1,914	2,192	2,755	2,980	2,704	72.0
Foreign: Bonds	5	12	19	35	56	69	
Stocks	316	553	815	1,268	1,177	974	
<u>Trust Companies</u>							
Total Assets (at cost)	3,488	3,923	4,353	4,980	5,771	6,564	88.3
Foreign: Bonds & Stocks	5	14	23	22	63	29	
<u>Fire & Casualty Cos.</u>							
Total Assets (at cost)	1,800*	2,041	2,304	2,516	2,758	3,088	71.7
Foreign: Bonds & Stocks	80*	86	82	75	73	81	
<u>Mortgage & Loan Cos.</u>							
Total Assets (at cost)	2,438	2,570	2,772	2,978	3,292	3,778	54.3
Foreign: Bonds & Stocks	4	4	5	5	8	10	
Total Assets	28,200*	29,825	32,638	35,868	39,138	42,153	49.4
Foreign Investments	835*	1,197	1,629	2,233	2,410	2,038	
Foreign Investments as % of Total Assets	3.4	4.0	4.9	6.2	6.1	4.8	

* estimated

10. Assembled from the following different sources:

Statistics Canada: Trusteed Pension Plans, Catalogue
No. 74-201 Annual; Financial Institutions,
Catalogue No. 61-006 Quarterly.

Based on data from The Canadian Life Insurance
Association.

Based on data from Statistics Canada, Financial
Institutions Section.

While Table 7 deals only with federally incorporated financial institutions, it does give us some guide to past performance. As a group the high in foreign investments was 6.2% in 1968 reduced to 4.8% in 1970. The dramatic exception in the group was the mutual funds which, in 1970, had \$1,043,000,000 or 39% of the assets under administration invested in foreign securities. We return to the institutional investor with recommendations further in this Report.

The Problem of the Small Company

3.11 Public equity offerings are costly and often unavailable for small enterprises. Furthermore an absence of earnings history often makes it impossible for the new venture to find financial sponsorship. Even when an issue is publicly distributed, investment in a small company is unattractive or prohibited to the institutional investor. He must look for an established record, and liquidity and breadth in the market place. The institution has large sums of money to invest, and economies of scale preclude small equity participations. In addition, the institution is prohibited from purchasing greater than a stated percentage of the equity of an individual corporation and in many smaller companies the minimum size of the profitable investment from the institution's point of view would exceed the maximum percentage of that company that the institution is permitted to take. To summarize, the traditional lenders tend to supply only current needs. There are few institutions functioning as merchant banks to find equity capital for the newer type of venture. Government assistance is limited. The securities industry finds raising

capital for the small business uneconomical, or requires a bonus or option arrangement from the owners which may discourage them. The pools of managed savings are not available to them.

Conclusions

3.12 To arrest the export of savings by institutional investors and simultaneously to encourage wider distribution of Canadian equity securities to Canadians, it is the clear task of government and the securities industry, with the aid of the institutional investor, to develop and encourage a more broadly based Canadian equity market. In pursuing this objective it is important to recognize that a substantial volume of the trading of the larger Canadian public companies presently takes place outside of Canada. Professor Conway, in his study "The Supply of, and Demand for, Canadian Equities"¹¹ points out that in 1967, for the 101 largest listed Canadian companies one-third of the total value of trading took place on U.S. exchanges.

3.13 The institutional investor is growing in importance, both with regard to mobilization of savings and activity in the securities market. As this occurs, the role of the individual investor diminishes, and it appears that this trend is irreversible. Yet the individual remains important in establishing liquidity and current market prices. The Canadian securities industry is following the example currently under critical discussion in the United States and is becoming increasingly concerned with the requirements of institutions. At the same time the Canadian

11. A Study commissioned by The Toronto Stock Exchange, 1968.

industry continues to recognize the importance of the small investor. If it fails in this endeavour the individual will effectively be denied direct access to the market place.

3.14 Canadians have traditionally shown a relatively high rate of personal saving. At the same time, to meet the capital needs of a rapidly expanding economy, we have depended on foreign capital. This may not be as readily available. It is clear that there will be a continued demand for capital. The trend is away from individual saving and into pooled savings through institutions. Our object then is to ensure that the Canadian securities industry will be adequately capitalized. Thus it will be properly equipped to encourage and facilitate the optimum investment of Canadian savings, efficiently allocating domestic capital to Canadian needs.

THE SECURITIES INDUSTRY IN ONTARIO

A. THE EXISTING ANATOMY

"Securities Industry" Defined

4.01 For the purpose of this Report the "securities industry" means those financial intermediaries required to obtain registration in some principal capacity under The Securities Act. In some areas our comments have a general application to the securities industry and equivalent financial intermediaries in all of the Canadian provinces. They influence, direct and manage the investment of Canadians' savings.

Institutional Investors

4.02 There is another group of financial intermediaries, apart from governments and government agencies, who solicit personal savings for investment. These are the institutional investors¹. As discussed in Chapter III they manage pools of personal savings, making them available to help meet Canadian capital needs. As with the securities industry the majority of this group are regulated and supervised under appropriate legislation².

1. Defined supra, Ch. I, footnote 8.

2. For representative examples see the following Ontario and Canada statutes:

The Credit Unions Act, R.S.O. 1970, c. 96, s.38.

The Insurance Act, R.S.O. 1970, c. 224, especially Part XVII.

The Investment Contracts Act, R.S.O. 1970, c. 226.

The Loan and Trust Corporations Act, R.S.O. 1970, c. 254, s. 150 and following, and Regulation 570, R.R.O. 1970, s. 11.

The Pension Benefits Act, R.S.O. 1970, c. 342, by Regulation 654, R.R.O. 1970, s. 14.

"Registrants"

4.03 Section 1(1) of The Securities Act defines three main classes of activity requiring registration under section 6. A "dealer" trades in securities in the capacity of principal or agent. An "adviser" engages in or holds itself out as engaging in the business of advising others as to the advisability of investing in or buying or selling securities. An "underwriter" may either as principal or agent distribute securities to the public, but he may only do so by virtue of another class of registration or exemption from registration. "Distribution to the public", a complex concept described in section 1(1), clause 6a, normally involves the filing of a prospectus as required by section 35. There are exemptions from the statutory registration requirements of section 6 available under the special circumstances described in section 18 (for advisers) and section 19 (for other registrants).

"Classes of Registrants" - Securities Act Regulations

4.04 The "dealer" and "adviser" categories are further classified by the regulations to The Securities Act according to differences in function and membership in the recognized self-regulatory bodies³. The "classes of registrant" are as follows:

- (1) The "advisers" are classified as:
 - (a) "investment counsel" advises others as

2. cont'd.

The Trustee Act, R.S.O. 1970, c. 470, s. 26 and following.

The Bank Act, R.S.C. 1970, C. B-1.

The Cooperative Credit Associations Act, R.S.C. 1970, c. C-29.

The Canadian and British Insurance Companies Act, R.S.C. 1970, c. I-15.

The Foreign Insurance Companies Act, R.S.C. 1970, c. I-16.

The Loan Companies Act, R.S.C. 1970, c. L-12.

The Pension Benefits Standards Act, R.S.C. 1970, c. P-8.

3. R. R. O. 1970, Reg. 794, s. 2(1) and (2).

to the advisability of investing in specific securities or giving continuous advice as to the investment of funds on the basis of the individual needs of each client; or

- (b) "securities adviser" advises either directly or through publication or writings as to the advisability of investing in specific securities.

(2) "Dealers" are classified in one or more of the following groups:

- (a) "broker" - a member of the Toronto Stock Exchange who trades exclusively as an agent;
- (b) "broker dealer" - a member of the Broker Dealers' Association of Ontario who may trade as an agent or principal and who automatically receives registration as an underwriter;
- (c) "investment dealer" - a member of the Investment Dealers' Association of Canada, who may also trade as an agent or principal and who automatically receives registration as an underwriter;
- (d) "mutual fund dealer" - registered exclusively to trade in securities of mutual funds. Members of the Canadian Mutual Fund Association have modified conditions attached to their registration;

- (e) "scholarship plan dealer" - registered to trade exclusively in the securities of a scholarship or educational plan or trust;
- (f) "securities dealer" - trades either as principal or agent and is automatically registered as an underwriter, but is not a member of one of the recognized self-regulatory bodies; and
- (g) "security issuer" - registered to trade exclusively in securities of his or its own issue.

(3) "Underwriter" is not subdivided into classes. The "underwriter" who is registered in no other capacity may only distribute to the public through other classes of registrant. Broker-dealers, investment dealers and securities dealers, each of whom is registered to trade as principal as well as agent, are deemed to be granted registration as underwriters. This permits them, and the issuer with whom they are dealing, to enjoy the exemption contained in section 19(1)6 and section 58(1)(c) of The Securities Act.

Conditions of Registration

4.05 Section 6 of Regulation 794 and the rules made under the section attach detailed conditions to each class of registration⁴. These range from minimum capital requirements, bonding and insurance, compensation or contingency trust fund participation to record keeping, business procedures and audit requirements. A significant minimum

4. Ibid.

amount of capital is required for each of the classes, increasing as the volume of business increases.

Functional Differences: Principal or Agent

4.06 The classes detailed in 4.04 are useful in that they give proper recognition to the role of the self-regulatory body and provide minimum requirements for each class of registrant. The "dealer" frequently performs two functions. As agent, the firm may purchase or sell for the customer's account. As principal, for its own account, it may purchase from and sell to a member of the public or to another dealer. The former is commonly regarded as the "broker" function and the latter as the "dealer" function.

4.07 As agent the "broker" is paid a commission for his services. He may provide a number of additional services including the provision of investment advice (for which he may or may not levy a separate charge), the extension of credit through margin accounts, the custody of securities and the collection of dividends.

4.08 The true "dealer" buys as a principal, often through an underwriting, and sells for his own account. With the exception of a few broker dealers and the specialized classes - security issuers, mutual fund dealers and scholarship plan dealers - there are few securities firms in Canada who act exclusively as dealers. Indeed two or more classes of registration are common and many securities firms are members of both the IDA and TSE as well as stock exchanges in other jurisdictions.

The Underwriting

4.09 The most important function of the dealer for

the purpose of this Report is the underwriting of securities and their distribution to the public. Put in its simplest terms the dealer-underwriter purchases securities from an issuer for resale as principal to the public.

Originating, Banking and Selling Groups

4.10 The Moore Report⁵ describes the sophisticated groupings necessary to the underwriting of certain issues. Where the "originating" or "purchasing" dealer or dealers wish assistance in financing the purchase and effecting the distribution of the issue to the public either one group, "the banking group", or two groups, "the banking group" and "the selling group", become involved in addition to the originating or purchasing group. The originating or purchasing group finance the underwriting through an agreement as to the percentage of the liability to be accepted by each participant jointly and severally. They undertake the risk and accept the liability if the issue is not sold. To reduce their risk the originating or purchasing group may invite other dealers to commit themselves to purchase a specific percentage of the underwriting. The combined group is then known as the banking group. The added members, however, are only liable to the originating group for their specific commitment. The selling group may be formed to facilitate a wider distribution of the purchased securities. The members of the selling group assume no risk excepting for the amount allotted to each of them as a member of the selling group.

4.11 The earnings of each group are based upon the difference between the price at which the securities are purchased and the price at which they are sold to the public. The originating group, although part of the banking group, will

5. Op. cit., Ch. I, footnote 11, pp. 22-23.

usually enjoy the largest discount because it negotiates the terms and details of the issue. The remainder of the banking group receive a somewhat lesser discount. The selling group, which undertakes none of the ultimate liability and little of the risk of the issue not being sold, receives the smallest discount.

Types of Underwritings

4.12 In broad terms the underwritings range from direct or guaranteed government securities through the permutations of corporate debt obligations and share issues. The Bank of Canada, for instance, has the responsibility for the distribution of Government of Canada securities but to do so it employs the majority of Canadian dealers, including all of the investment dealers, in its selling group.

Initial Distribution to the Public

4.13 The Moore Report⁶ describes five types of primary or initial financing. These are:

- (1) A negotiated public offering, either through an underwriting or on a best efforts basis, where the issuer and the dealer negotiate the type and terms of the security to be offered: provincial, municipal and corporate issues are often distributed in this manner.
- (2) A stock offering to shareholders, usually through a right to purchase shares based on the number of shares owned, where the dealer guarantees the minimum proceeds to the issuer by underwriting the whole or part of the issue or agrees to negotiate to buy the unsubscribed shares not

6. Ibid., at p. 23.

taken up by the shareholders.

- (3) A private placement, where the dealer acting as agent of the issuer, negotiates a sale to one or more buyers - usually institutional investors.
- (4) The purchase of all or part of an issue offered by public tender, a method used in the past by some provinces and municipalities but now rare except for some smaller municipalities.
- (5) Distribution through stock exchanges, permitted in Ontario after the filing of a statement of material facts acceptable to the Commission and the TSE, with the rules differing on the various Canadian stock exchanges.

As noted in (4) above issuers in Canada do not invite dealers to tender to supply required capital. We note with concern the seeming lack of competition among dealers in vying to become the financial adviser and originating dealer (prime underwriter) for major Canadian companies. These arrangements tend to become "traditional"⁷.

Secondary Trading

4.14 Secondary trading, or the buying and selling of securities which are already issued and distributed to the public, occurs in four distinct categories or "markets". The first of these is the recognized stock exchanges where the companies whose securities are listed and posted for trading must initially satisfy, and continue to satisfy,

7. See the similar concern expressed in 1964 in the Porter Report, op.cit., Ch. II, footnote 3, pp. 309-315.

certain minimum standards relating to such matters as assets, earnings history and breadth of share distribution tests. This is the most familiar market where its broker-members execute trades in the listed shares as agents on behalf of their clients. This traditional role has recently been varied to permit so-called "liability trading" which permits a broker, attempting to sell a large block of listed securities for a client, to purchase the balance of the block for his own account under strictly defined conditions in order to complete the sale for the client. The broker will sell the balance of the block for his own account when market conditions permit⁸. The second market is the unlisted or over-the-counter (also called "between-dealers") market. This includes trading in medium and long term government and corporate debt securities, commonly called the "bond market", as well as trading in unlisted shares. The dealer frequently takes a position in this market as principal, buying and selling for his own account. The third market involves trading listed securities between dealers who are not members of the appropriate stock exchange and not through the facility of that exchange. The fourth market involves a facility, used by institutional investors in the United States, which merely matches orders but makes no attempt to find buyers or sellers. These latter two types of market have not assumed the importance in Canada that they have in the United States where they have had substantial impact on the stock exchanges.

Money Markets

4.15 The little discussed "money market" has assumed tremendous importance during the past decade. Since its

8. Op. cit., Ch. I, footnote 10.

trading is between sophisticated parties it has attracted little public attention. Its name is derived from the short term debt securities in which its participants trade. They are attractive to investors who have a short term cash surplus they wish to invest. Money market securities include federal, provincial and municipal government and corporate debt securities, including bankers' acceptances, with maturities up to three years - but usually considerably less⁹. There are fifteen "official" money market dealers who have received official approval or designation as such from the Bank of Canada, two of whom are non-resident owned¹⁰. As a result the official dealers are given a line of credit which entitles them to use the Bank of Canada as a lender of last resort. In turn the Bank of Canada exercises some surveillance over their financial affairs to satisfy itself as to their stability. The dealers usually use their borrowing privileges at the chartered banks against the collateral of government treasury bills, short term bonds and certain bankers' acceptances. The official dealers are the instruments through which the Bank of Canada implements its monetary policies. It is important that these dealers remain sympathetic and susceptible to policy guidance by the Bank of Canada.

4.16 There is also in a broader context an "unofficial" money market in which other dealers also participate. This market includes the placing of newly

9. Taken from the Moore Report, op. cit., Ch. I, footnote 11, p. 24.

10. The "official" money market dealers are listed in Appendix "E".

issued and trading in already outstanding short term corporate debt obligations called commercial paper. The dealer may trade in commercial paper as agent for a client or buy or sell for its own inventory.

Other Broker and Dealer Services

4.17 The Moore Report points to several other broker and dealer services¹¹. Securities firms provide clients with information upon request. They offer investment advice to their clients and frequently issue market commentaries and recommendations. They may provide portfolio management service as investment counsel. Some firms manage one or more pooled accounts, known as "in house" mutual funds, which are qualified for sale to the public through a prospectus. We earlier noted their convenience services: margin accounts, custody for clients' securities and the collection of interest and dividends. Securities firms now advise corporate clients on a fee basis on a wide range of business problems including mergers, acquisitions, corporate re-organizations and even economic forecasting and future expansion. This is allied to their traditional role as corporate financial advisors.

The Other Registrants: Advisers, Underwriters, Security Issuers, Mutual Fund Dealers and Scholarship Fund Dealers

4.18 As noted previously ("Classes of Registrant" par. 4.04) each of the remaining classes of registrant has a limited and specific function. Registrants holding only one of these classes of registration can not participate in the kinds of dealer activities we have been discussing. Within those limits each class and category is important

11. Op. cit., Ch. I, footnote 11, commencing at p. 24.

for the influence it exerts on the direction of savings.

Activities of Non-Ontario Registrants

4.19 During the course of the hearings, through the briefs presented to us, a submission made recently by the Ontario District of the IDA¹², and the rather extensive feature which appeared in the December 4th, 1971, issue of The Financial Post under the heading "Where the Money Goes"¹³, it became apparent that the use being made of the exemptions contained in sections 19(1)3 and 19(3) of The Securities Act goes far beyond anything contemplated by the legislators. The exemption permits non-registrants to trade without the necessity of Ontario registration with sophisticated classes of the investing public - including banks, loan and trust companies, insurance companies, and "recognized" exempt purchasers. The exemption was created long before the institutional investor became such a powerful force in the market place. Many of the important classes of institutional investors, particularly mutual funds, pension funds and the managed trustee funds, are not exempt. We are satisfied that Canadian institutional investors have been offered new U.S. issues by the U.S. firms whose direct lines are listed in the yellow pages of the Toronto telephone directory. These new issues were not qualified for sale in Ontario. Continuing sources of information, and the various protections afforded to Ontario residents in Ontario under Ontario law, are not available to the institutional investor who purchases the securities of non-reporting companies. While an exemption

12. Supplementary submission of January 5, 1972 of the Investment Dealers Association of Canada, p. 4.

13. The Financial Post, December 4, 1971, p. 14.

from the prospectus requirements may be available under section 19(1)3 and section 58(1)(a) or section 19(3) and (4) and section 58(1)(b) in either case a report in Form 11 pursuant to the regulations is required to obtain the exemption. We are informed that such forms are not being filed.

4.20 We are concerned. From our limited enquiries it is apparent that there are a number of U.S. broker-dealers, who prior to July, 1971 had not attempted to obtain registration in Ontario, who continue to trade with the institutional investors' money managers through their direct solicitation. They send salesmen to Canada as well as contacting the institutions by telephone and by mail. It should be observed that this limited information indicates that the U.S. firms have been encouraged in their actions by some Canadian money managers. The American firms appear to be large and otherwise responsible dealers. Their activities may result from casual indifference to Canadian law. The Ontario money manager may find the greater spectrum for investment and the research and trading facilities offered to him appealing. The fact that he is removing his institution from the Ontario safeguards gives rise to a proper ground for concern. We have already noted the SEC's desire for greater control over the self-regulatory bodies resulting in part from the failure of a substantial number of U.S. securities firms and a number of disciplinary actions which has given rise to introspection among the members of the New York Stock Exchange¹⁴. We view it important that Ontario registrants be used by Ontario money managers whether the ultimate decision be to trade in United States or other foreign securities or not.

14. Supra, paras. 2.12 and 2.13.

B. OWNERSHIP: THE CAPITAL STRUCTURE OF
ONTARIO SECURITIES FIRMS

Ownership and Professional Management

4.21 With certain notable exceptions, of recent origin, all Ontario dealers (except security issuers) are proprietorships, partnerships or privately owned corporations¹⁵. Through the registration procedures, commencing with the initial application, the Commission believes that it is important to know who may directly or indirectly be in a position to influence management. The concern has extended through direct and indirect ownership to lenders and guarantors. The process is intended to insure not only that management, for whom trading privileges are being sought, are honest, of good reputation in the community, and competent to deal with the public in securities, but that they are not susceptible to influences not readily apparent through the application and screening process. The point is emphasized by the Toronto Stock Exchange in its brief¹⁶. The IDA brief emphasized professionalism¹⁷. Ownership, in the Ontario context, has usually brought with it the right to manage. However, the real concern must remain that the registrant should be managed by competent professionals not subject to unwholesome outside influences.

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15. For example, the following publicly owned firms hold registration: Merrill Lynch, Royal Securities Ltd., Bache and Company Inc., Metropolitan Life Insurance Company Ltd., Prudential Life Insurance Company of America.
 16. Submission by The Toronto Stock Exchange to the Industry Ownership Study Committee of the Ontario Securities Commission, pp. 1 and 2.
 17. Submission by the Ontario District of the Investment Dealers Association of Canada to the Ontario Securities Commission Industry Ownership Study, pp. ii and iii.

Capital Defined

4.22 The Moore Report speaks of capital as the contribution made "below the line" by the proprietors, partners or shareholders as opposed to the obligations "above the line" to clients, banks and other lenders¹⁸. The capital "below the line" includes the share or partnership capital, subordinated loans, surplus and undivided profits and other reserves which cannot be readily withdrawn. In Ontario the Commission and the self-regulatory bodies have net free capital requirements and precise rules for calculating it¹⁹. Net free capital is a cushion available to meet unforeseen contingencies.

Subordinated Loans²⁰.

4.23 Capital is contributed to the firm either through the purchase of additional equity or through loans. In order that the loan will not impair the net free capital the lender may be asked to agree that his claim for repayment of principal and interest will rank behind, or be subordinated to, all other creditors of the firm but ahead of withdrawals of capital by or distribution of assets on winding up to partners or shareholders. This is a subordinated loan. Frequently a partner or shareholder will raise money by personal loan from a bank, pledging his partnership interest or shares as collateral, and then lending the money to the firm under a subordinated loan

18. Op. cit., Ch. I, footnote 11, pp. 44-45.

19. Regulation 794, R.R.O. 1970, s. 6, Toronto Stock Exchange By-laws 18.01 and 18.02, and the Investment Dealers Association of Canada Constitution, By-laws and Regulations, By-law No. 17 and Regulations 100 to 106.

20. Subordinated Loans are at times referred to as "subrogated loans".

agreement. The use of the subordinated loan to inject capital into a firm has grown rapidly in the securities industry, particularly in the past several years. It should be noted that the claims of subordinated lenders are not paid by the industry's National Contingency Fund or under any of the Contingency Trust Funds established for other classes of dealer under the regulations to The Securities Act²¹.

The Turnover Problem

4.24 The Moore Report concluded that alternative sources of capital would alleviate what it described as the turnover problem²². The owners of the firm are usually its managers. Upon their retirement or death there is a real problem in liquidating the interest of the owner. This has been alleviated in some firms through a system under which the senior "partners" are bought out through a "buy-sell agreement" during the years preceding retirement. In either case, the necessity of liquidating or acquiring the interest of a retiring principal, adds some pressure to remove the profits from the firm and not to leave them for capital expansion.

The Need to Resolve the Turnover Problem

4.25 The problem is of real concern. It may well prove a continuing spectre which, when added to the constant pressure to maintain adequate capital, gives an aura of impermanence or instability to the firm throughout its existence. It may serve to constrain the firm from con-

21. See Regulation 794, s. 6(4) and Form 8, Article V.

22. Op. cit., Ch. I, footnote 11, pp. 56-57.

sidering ventures which it might otherwise undertake. The owners may be deterred from undertaking innovation and expansion. The junior members become heavily indebted in order to purchase the interests of their seniors. In order to do this the juniors frequently borrow money from lending institutions. Earnings are paid out to meet these loans and not retained for expansion. There is now some evidence that lending institutions are in a position to exert influence on the policies of the firm, particularly when they agree to subordinate the loan so as not to impair free capital.

C. FINANCIAL PROFILE

General Observations

4.26 To elicit financial and other information from members of the securities industry, a questionnaire was distributed to all registrants with the assurance that information provided would remain confidential with respect to the particular firm. That questionnaire, together with the explanatory materials accompanying it, will be found as Appendix "B". While it would have been preferable to have pretested the questionnaire, constraints of time did not permit this²³. Registrants were requested to direct any enquiries to those of our staff who were analysing the results. The staff made supplementary enquiries to obtain additional facts and explanations. These discussions also gave direction as to the type and formulation of information solicited. The analysis of the data is presented in this

23. See our comments on this, supra, par. 1.12.

chapter as it pertains to four important segments of the securities industry: namely investment dealers, brokers, broker-dealers and securities dealers. The other classes of registrant engage in limited activity and the data obtained is of limited assistance in assessing capital requirements. Further data from the questionnaire and analysis will be found in Appendix "F". The data in this chapter generally relates to the financial operations of resident owned registrants only. Financial information from non-resident owned firms is included for particular purposes only in specific instances in the analyses and, where used, is clearly identified. Financial information from non-resident owned firms could not be quantified precisely because a majority of them conduct their Canadian operations through branch offices which are consolidated with their overall international activities. This situation will be changed shortly because by July 13, 1972²⁴ non-resident owned registrants will be required to incorporate a Canadian company for their Canadian operations and keep separate financial statements. It is important to stress that the figures in the tables which follow are not precise. Several reasons account for this, including the fact that many firms have not kept records on the basis requested in the questionnaire, and several firms simply have not compiled records of their expenses and so could supply estimates only. We believe, however, the figures are reliable to the extent of showing significant trends in the industry.

24. Regulation 794, s. 6a(3)(c).

Table 8. Questionnaires²⁵

			<u>Reply Received</u>				
	Registered as of <u>Sept. 30</u>	Quest. sent <u>Oct. 8</u>	<u>Total</u>	Consoli- dated with <u>others</u>	New* or terminated** <u>firms</u>	No reply	
Investment Dealers)							
Investment &)							
Securities Dealers)	90	90	85	-	4	5	
Investment Dealers &)							
Brokers)							
Brokers - TSE	12	12	12	5	1	-	
Brokers & Broker-dealers)							
Broker-dealers)	31	31	30	2	1	1	
Securities Dealers	19	18	16	2	1	2	
Mutual Fund Dealers	33	33	27	-	4	6	
Scholarship Dealers	2	2	2	-	-	-	
Investment Counsels	34	33	28	2	1	5	
Securities Advisers	<u>4</u>	<u>4</u>	<u>3</u>	<u>-</u>	<u>1</u>	<u>1</u>	
	225	223	203	11	13	20	

* Did not complete a financial year by March 31, 1971.

** Terminated registration before December 31, 1971.

25. A number of firms hold registration in more than one category, for example as an investment dealer (and member of the IDA) and as a broker (and member of the TSE). Where such is the case the firm's financial statements have been prepared on a consolidated basis, and thus financial information from each of the categories in which the firm is registered has been merged to reflect the whole of the firm's operations. As the groupings above indicate, a firm with registration as both an investment dealer and a broker appears only as an investment dealer, with consolidated information, and not again as a broker. A firm with registration as both a broker-dealer and a broker appears only as a broker-dealer, and not again as a broker. This preference for the "dealer" category in the case of choice reflects our conclusion that the "dealer" operations require more capital than do the "broker" operations.

1. Investment Dealers

4.27 The first category for which information will be examined is that of investment dealer. A number of firms included in this listing have incorporated in their consolidated statements data respecting their associated broker firm.

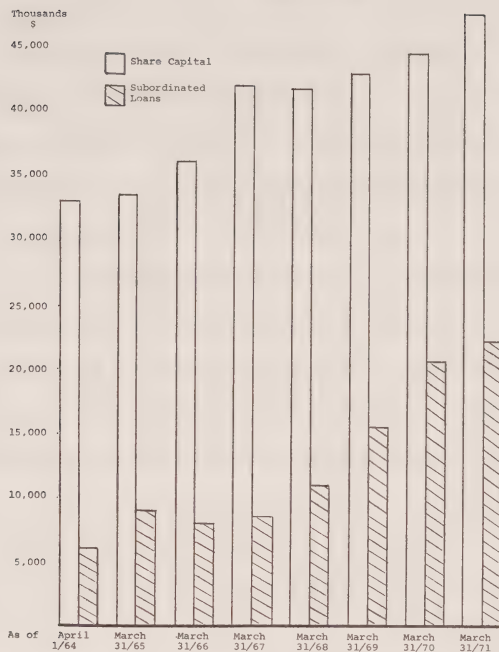
Table 9. Investment Dealers - Form of Ownership		
<u>Form</u>	<u>Canadian</u>	<u>Foreign</u>
Corporation	61	9
Partnership	6	1
Proprietorship	2	-
Corporation and Partnership	<u>2</u>	<u>-</u>
	71	10

Assets, Liabilities and Capital

4.28 A statement of assets, liabilities and capital was requested for a financial year ending between April 1, 1970 and March 31, 1971. Table 10 in Appendix "F" shows that the assets of 71 resident owned investment dealers totalled \$1,671,057,000. As demonstrated by Table 11 in Appendix "F", the five largest resident owned firms controlled 58.1% of this total and the ten largest resident owned firms controlled 80.5% of this total. The two largest non-resident owned firms rank second and sixth largest in assets. When the assets of these two largest non-resident owned firms are added to the total assets of the 71 resident owned investment dealers, the twelve largest firms control 83.6% of this total.

4.29 As shown in Table 12 in Appendix "F", in the seven years to March 31st, 1971 share capital in the 71 resident owned investment dealers increased gradually from \$33,000,000 to \$48,000,000, representing a growth of 45% during the period. Subordinated loans, however, soared from \$6,000,000 to \$22,000,000, an increase of 267% for the period. The chart on the next page illustrates the change in capitalization.

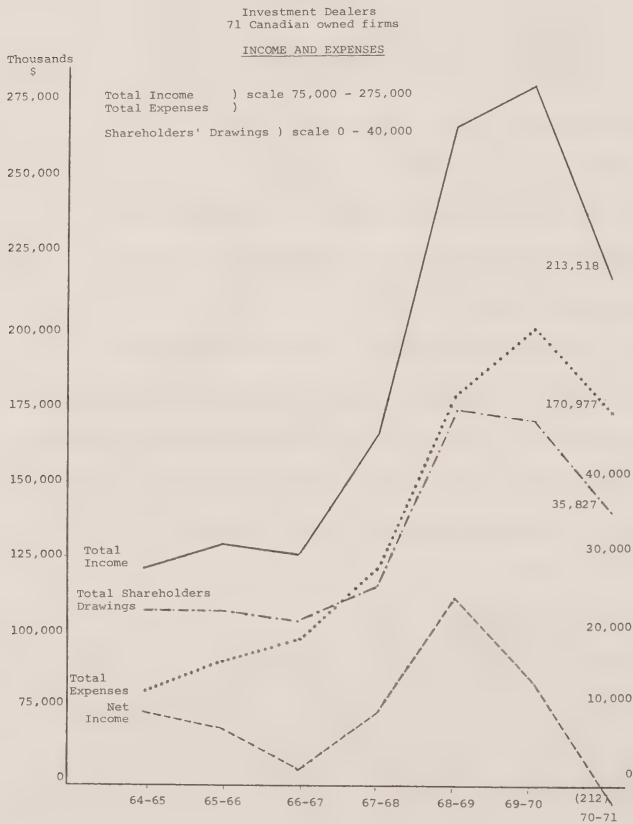
Investment Dealers
71 Canadian owned firms
CAPITAL AND SUBORDINATED LOANS



Income and Expenses

4.30 The graph reproduced below illustrates the dramatic rise in gross income for 71 resident owned investment dealers accompanying the increasing market activity over the period 1966 to 1970. Expenses show a parallel rise. However, when gross income declined drastically in 1971, commitments to research, equipment, communications and occupancy could not be reduced correspondingly and thus expenses did not show a parallel fall. Remuneration to employees shows a much closer relationship to gross income. The result was that while revenues increased by 79% over the period 1965 to 1971, expenses rose 116%, and net income before remuneration to shareholders/partners was thus up only 8%. Remuneration to shareholders/partners remained relatively constant for the period 1964-1968, but then increased sharply in 1969.

It remained at that level in 1970 before decreasing in 1971, although this reduction was not sufficient to prevent a net loss after tax in that year of some \$212,000. However, the net income figures are somewhat misleading because some partnerships responding to the questionnaire have withdrawn all income, showing no net income after payment of income taxes and shareholders/partners remuneration. Also, some partnerships have shown the same income before and after remuneration. Again while these reporting differences make compilation of accurate figures impossible, the available data does permit the determination of trends and projections.



4.31 In examining the data in Table 14 on the following page regarding gross income and expenses it must be noted that the five largest Canadian owned firms took 35.8% of total gross income while gross expenses for these five amounted to only 25.0% of total expenses for the group of 71 Canadian owned investment dealers. The efficiency of size is again illustrated when the percentages of the total gross income and expenses taken by the ten largest resident owned firms, 49.0% and 46.0% respectively, are compared. With regard to net income after remuneration to shareholders and partners (which amounted to 16.4% of gross income), while two of the five largest resident owned firms showed profits totalling \$2,189,000, the Canadian owned investment dealers as a group had a loss of \$212,000. Twenty-four of the seventy-one Canadian owned firms suffered losses after remuneration to shareholders and partners in the fiscal year ending March 31, 1971 or before, including two of the five largest resident owned firms. Those firms deriving the main portion of their incomes from commissions increased their revenues substantially during the height of the market activity (the fiscal years 1968 - 1970), but found the subsequent decrease to have a severe effect on earnings in the following year. Those firms trading for their own accounts, primarily in bonds, maintained an above average gross income in the 1970 - 1971 period.

Table 14. Income and Expenses
Largest Resident Owned Investment Dealers

Fiscal year ended
between April 1/70
and March 31/71
thousands of dollars

	<u>Income</u>	<u>% of Total</u>
5 largest resident owned	\$ 60,806	35.8
10 largest resident owned	106,044	49.0
2 largest non-resident owned	21,406	
12 largest investment dealers	127,450	53.5*
 <u>Expense</u>		
5 largest resident owned	43,097	25.0
10 largest resident owned	79,425	46.1
2 largest non-resident owned	16,655	
12 largest investment dealers	96,080	51.0*

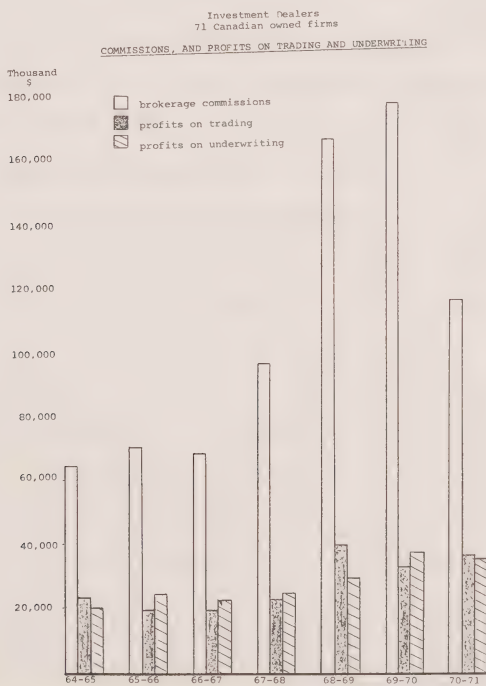
Commissions

4.32 Most of the registrants indicated that they do not segregate retail and institutional accounts. Thus from this survey it is difficult to ascertain any trend away from retail in favour of institutional business. Similarly it is impossible to assess precisely the impact of the activities of non-registrants as described in paragraph 4.19. The pools of savings accumulated by institutional investors have increased significantly in the past seven years²⁶, and it seems probable that Canadian-registered securities firms have received a share of this business notwithstanding the activities of non-registrants. Commissions earned by investment dealers show a substantial rise from \$65,000,000

26. See supra, Ch. III, Table 7.

* of 71 resident owned and 2 largest non-resident owned investment dealers.

to \$178,000,000 between 1965 and 1970, with a severe decline to \$116,000,000 in 1971. Profits from trading and underwriting have grown more gradually, although significant increases were experienced in trading in 1969, and underwriting was the subject of lower volume but high profitability in 1970, and the reverse in 1971. These trends are indicated by the chart reproduced below. We attempted to obtain a breakdown of commissions earned in order to test the statement in the Moore Report that foreign companies with offices in Canada concentrate on the sale of foreign securities to Canadian clients²⁷. These returns to the questionnaire were quite inconclusive. Apparently most Canadian owned firms do not break down commission revenues into those from sales of Canadian securities and those from foreign securities.



27. Op. cit., Ch. I, footnote 11, p.126.

Underwriting

4.33 Table 16, Appendix "F" illustrates the figures on underwriting given in response to the questionnaire. It would appear that these were for the most part estimates, and that most firms keep rather indifferent track of their own participations. The totals for all underwriting differ greatly from the figures given in the Bank of Canada Review for New Security Issuers²⁸, even having regard for the fact that our survey is confined to Ontario registrants only. The five largest resident owned investment dealers (as ranked by assets) underwrote an average of 40% of the recorded transactions, and the ten largest resident owned firms handled 60%. These ratios have remained relatively constant in recent years.

2. Brokers

4.34 In addition to those firms registered as investment dealers and acting as brokers, and those firms registered as broker-dealers and acting as brokers, there are five firms registered solely as brokers and functioning only in that capacity. Similar statistical information as that pertaining to investment dealers will be found in Tables 17 through 21 in Appendix "F".

Capital and Subordinated Loans

4.35 The somewhat precarious balance on which this segment of the industry hangs is illustrated by the 1971 balance sheet, reproduced as Table 18. When subordinated loans are considered as capital, the debt/equity ratio is some 3.3 to 1. If such loans are regarded as

28. Bank of Canada Review, December, 1971, Table 25, Net New Security Issues Payable in Canadian and Foreign Currencies, s. 61.

debt, the ratio becomes 5.8 to 1. The annual levels of capital and subordinated loans are set out in Table 19. Capital reached its highest level in 1968 and was reduced somewhat in each of 1969 and 1970, with some replacement in 1971. Corresponding changes in the amount of subordinate loans indicate the shifting but growing reliance on this form of financing. The highest level, in 1970, corresponded with the lowest amount of permanent capital.

Income and Expenses

4.36 Income underwent an extreme increase in 1968-69 over 1967-68, followed by a substantial decrease in 1970-71. Among expenses, changes in remuneration closely paralleled movements in income, while research received substantially more funding in 1969-70, apparently indicating that this facet of the business was to receive more attention. The extreme decrease in expenditures on communications from 1964-65 to 1965-66 leads us to question the accuracy of the former year's figures. The fixed charges on this item in 1970-71 impaired the profits for that year, as did the increase in "occupancy and equipment" in that year. "Other expenses" more than doubled from 1967-68 to 1968-69, and by 1970-71 made up more than one-third of all expenses. This appears to be a rather substantial amount not to bear some further identification or explanation. The "payout ratio" of remuneration to shareholders/partners as to income before such remuneration was between 60 and 75% except for the fiscal years 1966-67, 1969-70 and 1970-71, when it has exceeded 85%. In fact in this past year the rate was very close to 100%. The result of these higher ratios is that net income fell from \$298,000 in 1968-69 to \$172,000

in 1969-70 and then to a loss of \$6000 in 1970-71.

3. Broker-Dealers

Capital, Income and Expenses

4.37 Some 27 firms are included in this category, although a number of them are also brokers. Again statistical information similar to that compiled for investment dealers and for brokers has been set out in Tables 22 to 26 of Appendix "F". Table 25, the combined Statement of Income and Expense for all the firms in this category bears some examination. Income of the group rose 36% in the seven-year period, but expenses were up 75%. Substantial increases in expenditures for research, facilities and equipment accounted for part of this, but the greatest portion was remuneration to employees, which by 1971 constituted 36% of expenses. The second largest item of expenses was that designated "Other Expenses", with no indication as to what was included. Income before shareholders' remuneration declined by 38% over the period although shareholders' remuneration increased by 107%. The result was that net income, which had risen in 1969-1970 declined to a loss of \$753,000 the following year.

Table 24 in Appendix "F" illustrates changes in capitalization for the period 1964 to 1971. The sudden decrease in capital of \$1,750,000 in 1964-1965 was due to the withdrawal of capital by one firm. In the period 1965-1971 capital increased by one-third, while in 1971 subordinated loans, after a significant rise in 1969, declined to below the 1965 level.

4. Securities Dealers

4.38 As is indicated by Table 8²⁹, 19 questionnaires were mailed to securities dealers and 16 were returned. Of these, seven were foreign corporations operating just branch offices in Canada, and two gave consolidated financial statements. One had ceased operation and one commenced business after March 31, 1971. Consequently the financial profile of the securities dealer category, reproduced at Tables 27 to 31 in Appendix "F" is based on the statistics of only five firms.

Capital and Subordinated Loans

4.39 Until 1969 the members of this category did not use subordinated loans at all. In that year the total was \$60,000, since rising to \$80,000. Capital increased by \$400,000 in 1970 and a further \$30,000 in 1971. A large portion of this was attributable to one firm just coming into the category. The debt/equity ratio in 1971, as shown by the balance sheet, Table 28, is 2.25 to 1.

Income and Expenses

4.40 The ratio of total expenses to gross income has remained relatively constant over the period, with a high point in 1966-67 and lows in 1964-65 and 1968-69. Income more than doubled in 1968-69 over 1967-68. In 1969-70, a good year for other categories, income to securities dealers decreased, but a very strong recovery followed in 1970-71. However, in regard to this latter the increase is in part accounted for by the entry of a new firm into

29. See par. 4.26.

this business. Regarding expenses, Table 30 indicates that research expenditures were almost unknown until 1970-71, when a substantial sum was expended on them. Communications expenses increased by substantial amounts in 1969-70 and again in 1970-71, although this latter is in part the result of the new entrant. Occupancy and equipment more than doubled, from \$65,000 in 1969-70 to \$140,000 in 1970-71. "Other Expenses" make up one-third of total expenses, again a very substantial proportion, and appear to parallel fluctuations in income. The "payout rate" of remuneration to shareholders/partners as to income before such remuneration varies from a high of 80% in 1965-66 to a low of some 48% in 1970-71. The result was that 1970-71 net income after tax was up substantially over previous years, and at 13.7% yielded a substantial rate of profitability on sales.

5. Capital Requirements

4.41 Schedule V of the questionnaire attempted to isolate functions of the securities industry which might or would be affected by demands for capital and to assess the feelings of the industry members as to the nature and quantity of this demand currently and in the future. From the replies received no distinct pattern as to the particular needs for capital for the different functions appeared. The information supplied clearly indicates that the "mix" of business has changed at least as on the dates examined, being March 31 of 1966, 1969 and 1971. In 1966, for example, one large investment dealer derived 18% of gross income and 28% of net income from the business of underwriting, while in 1971 only 9% of the gross and 2% of

net income was derived from this function. Another firm of comparable size received 44% of gross and 89% of net income in 1966 from underwriting and 42% of gross and 64% of net income in 1971 from that function. This latter firm also stated that brokerage, which had contributed 41% of the gross income in 1966, was in 1971 contributing only 26% of gross income. It is not possible to reach any but the most general conclusions as to the needs for capital and the profitability of specific functions. The staff of this Committee, which has been engaged in assembling and analyzing the data submitted by the registrants, reports that from their investigations and conversations it is apparent that cost accounting has been almost non-existent. Only a few firms indicated that they kept close track of their segmented or categorized profit/cost ratios.

Functions Performed

4.42 Table 32 in Appendix "F" is an examination of the functions performed by each of the four categories of investment dealer, broker, broker-dealer and securities dealer. The functions are advisory, brokerage, margin, dealer, merchant banker, money market and underwriting, and have been further subdivided to indicate responses of domestic and foreign, or non-resident owned firms. With regard to investment dealers, most firms indicated that they performed all functions listed except that of "merchant banker". While thirty-four firms indicated they do not provide "advisory" services, it is clear that they meant that they did not act as investment counsel or for an additional fee, but only provided this service as an adjunct to their trading function. Table 33 in Appendix "F" is set out in identical fashion, except that instead of being con-

cerned with whether or not the firms participate in a function, it indicates whether or not they have had to refuse business in that function within the past three years due to lack of capital. This was not the case with the majority of the functions, although a few investment dealers have had to refuse margin facilities, dealer functions, merchant banking, money market participation and underwritings for lack of capital. Two of the five resident owned brokers have indicated refusals of business for this reason in the functions of merchant banking, money market participation and underwriting. Three broker-dealers indicated a refusal to enter into underwritings due to inadequate capital.

Table 34 illustrates the results of a survey of investment dealers regarding the direction in which each of these functions as performed by them will change in the next two and the next ten years. Very few anticipated a decrease in any of the functions in either two or ten years. Expectations were generally mixed as to growth in most of the functions within the next two years, although it appears that more of those firms responding anticipate growth than no change. This was not the case respecting the function of merchant banking, in which most expected no change, or those of underwriting and brokerage, where growth was expected. Anticipation of growth over the longer term is quite clear, with again the exception of merchant banking. A large majority of the firms responding expect the functions of brokerage, dealing and underwriting to show growth. When it is remembered that these were areas in which a lack of capital has in the past restrained

business, it is important to take these expectations of growth into account in forming any policy respecting availability of capital. Table 35 shows the response of those indicating a lack of capital to the proposals set out in the Moore Report. Four resident owned and two non-resident owned investment dealers considered them insufficient, twenty-three resident owned and four non-resident owned investment dealers found them to be sufficient and forty-one did not answer. Two of the brokers felt the Moore Report proposals were sufficient to supply capital needs while four did not answer. Six broker-dealers considered the proposals satisfactory, nine found them inadequate and twelve did not respond to the question. Three resident owned and one non-resident owned securities dealer stated that the Moore Report proposals would supply the necessary capital, one felt they would not, and eight did not answer.

Table 36 sets out the responses by the various categories of registrants to the question "Is your firm sufficiently capitalized to perform the underwriting function at present?" Seven resident-owned and one non-resident owned investment dealer felt they were not, while sixty domestic and six foreign firms stated that they were sufficiently capitalized. Four brokers considered themselves undercapitalized for this function, as did four broker-dealers, although with respect to the latter category some twenty-two regarded themselves as being sufficiently capitalized to engage in underwriting.

Two resident owned securities dealers stated they were undercapitalized, while two resident owned and three non-resident owned firms felt they were not, with respect to underwriting.

D. Objectives for the Industry through the 1970's
The Principles

4.43 Three broad themes have been underlined during the Study. These are competition, innovation and efficiency. The goals are not new. Our recommendations must be mindful of these objectives. The result to be desired is a securities industry which reflects fairness, commands confidence and responds rapidly to the public interest as it becomes apparent. This public interest requires that greater opportunities be provided for the investment of Canadian savings by Canadians and their money managers in Canada. Any provincial policy must be influenced by Federal economic planning whether imposed through monetary and fiscal guidelines, an economic tribunal or some other form of constraint or persuasion. This Report is written in the uncertainty that is presently our national policy. At this date (April 15) Canadians have been advised that the policy will be announced in due course. A Select Committee of the Ontario Legislature is considering this question in a provincial context. In its Preliminary Report it noted the existence of this Study, and indicated that further consideration must be given to the matter of the financial industry³⁰.

Specific Objectives

4.44 We have concluded that there is a substantial number of specific objectives which must be provided for in the foreseeable future. These, without assigning any order of priority to them, include:

- (1) Provision must be made to resolve the turn-over problem. The constant drain on capital required

30. Op cit. Ch. II, footnote 9 at p.7.

to buy out the interest of senior partners reduces the working capital available for innovation and expansion.

- (2) There is an apparent need for greater administrative efficiencies. Some form of cost accounting is required by all firms.

- (3) Increasing demands will be made for more sophisticated plant and equipment. Electronic data processing services and techniques ranging through administrative procedures to automated trading and information equipment is available. Its cost is substantial.

- (4) The self-regulatory bodies continue to work towards greater group efficiencies. The TSE continues to study these questions and has considered central bookkeeping for its members which would tie into the central clearing system. The Canadian Securities Depository, while presently undergoing reassessment, holds great promise. Its ultimate cost, now already over \$1,000,000 in its preliminary stages, cannot be estimated excepting by those intimately associated with it. Indeed the upward revisions in its cost estimates led to a reappraisal instituted by its participants late in 1971.

- (5) An automated over-the-counter facility appears feasible on existing experience. It may have merit on a national basis for the stock exchanges. One cannot disregard the National

Association of Securities Dealers Automated Quote System (NASDAQ) which has been operating successfully for some time in the United States. It provides quotations on dialed request for the current bid and ask prices on over-the-counter securities and some listed securities across the nation through a television type display tube in the subscribing broker's office. The requesting broker, upon seeing a satisfactory quotation, uses the telephone to complete a transaction with the quoting broker.

- (6) The need for efficiency and innovation will dictate the need for better research facilities. Higher standards of securities analysis and research will be demanded to support many of these objectives. The Canadian institutional investor looks to the U.S. broker-dealer for advice because that dealer provides service and trading facilities available through only a few, if any, Canadian dealers. It may not be within the present capabilities of Canadian firms to offer such service. They must seek out reciprocal arrangements with foreign dealers which will enable the Canadian dealer to service Canadians in Canada and yet provide these clients with an adequate spectrum of investment opportunities.
- (7) The OSC Merger Study³¹ emphasized the greater

31. *Op. cit.*, Ch. II, footnote 5. See also Cohen, Milton "Truth in Securities Law Revisted", (1966) 79 Harvard Law Review, 1340.

need for liquidity in the market place, freeing up trading in issued and outstanding Canadian securities through the establishment of a continuous reporting system. The movement towards a national integrated securities market in the U.S.A. over the next few years must create significant pressures for integration and efficiencies in Canada with the attendant costs³².

- (8) While some institutional investors are not permitted by the law under which they operate to invest in companies without stipulated earnings records³³ the need of these institutional investors for more latitude is apparent³⁴. It is also apparent that these standards should be reappraised. There might be a move to the United Kingdom "prudent investor" standards under which the manager is permitted to accept bigger risks. This should be considered by the appropriate authorities, both federal and provincial. The pools of savings substantially exist in Canada. They must be freed up and channeled into Canadian investment. The Ontario

32. See the "Martin Report", op. cit., Ch. II, footnote 21, and a "Brief Submitted by the Toronto Stock Exchange to a meeting between Ontario Government Representatives and The Board of Governors of the Toronto Stock Exchange, January 17, 1972".

33. See, for example, Canadian and British Insurance Companies Act, R.S.C. 1970, c. I-15, s. 63.

34. This problem has been discussed previously with regard to the problems facing small businesses. See supra, Ch. III, par. 3.11.

Task Force Report, considering whether foreign capital is necessary for proper growth states: ³⁵

"Increased self-sufficiency in the Canadian capital market might be achieved by applying restrictions to the foreign investment activities of Canadian insurance companies, trust and investment companies, pension funds, mutual funds and other financial institutions. Such restrictions would serve to make more investment funds available to Canadian firms and to provincial and local governments which have often had to rely on foreign capital markets."

If the pooled savings are made available the onus will be on the dealer to provide the investment opportunities.

- (9) Securities firms must themselves more aggressively seek out new underwritings. They should be prepared to take more risk. The Moore Report conclusion³⁶ that the availability of additional capital during the period reviewed would not have better enabled the industry "to meet the demand for its services" appears to sidestep these questions. Dealers use certain criteria to determine whether they will underwrite a new issue. The unofficial Gray Report found the Canadian capital market inefficient and that financial institutions have been unwilling to take risks and support

35. Op. cit., Ch. I , footnote 12 , at p. 43 .

36. Op. cit., Ch. I, footnote 11, at p. 57 .

entrepreneurship. It states³⁷:

"The gaps are, broadly speaking, to be found in three places; venture capital for new and small firms; expansion capital for small and medium sized firms; and large pools of capital for major resource exploitation projects³⁸.

(10) Securities firms must be prepared to respond to the following pressures of the market place:

- (a) Revised commission structures including changes in negotiated commissions in the United States.
- (b) The need to assure the investor, particularly the institutional investor, of the continuous liquidity of the market place. Liability trading in stocks is but one present manifestation of this. Aggressive entrepreneurship means greater risk taking by the dealer which may add to the problems of his liquidity.
- (c) If market liquidity is not to be further diminished through the establishment of third and fourth markets, dealers and brokers must be diligent to support the effectiveness of the auction stock exchange market for listed securities and the over-the-counter market for unlisted securities.

37. Op. cit., Ch. II, footnote 13, at p. 13.

38. Clearly this is the very problem toward which the Canada Development Corporation is directed. See, for example, "Where the CDC May Aim First", Financial Post, December 4, 1971, p.1, and also "Where the Money Goes", at p. 14 of that same issue.

- (11) Official money market dealers must be sensitive to Bank of Canada and Federal Government economic objectives. The unofficial money market dealers, being exposed to a high risk, should have a substantial cushion of permanent capital. This coupled with the expansion of the money market, e.g. the recent decision of Manitoba and Ontario to auction treasury bills, suggests the need for additional capital.
- (12) While securities firms, according to the replies to the questionnaire, do not think of themselves as merchant bankers a number of them may, on a definition recently given³⁹, appear to have achieved this role through the expansion of their services, the range of corporate business advice to their clients, and in particular their involvement in private placements. Measured by the more traditional view of a merchant banker, one who by itself or in a consortium with others takes an equity position and interests itself in management of a venture, our dealers are not merchant bankers. There are few such financial intermediaries in Canada. To meet the gap suggested in the unofficial Gray Report the movement of the dealer into merchant banking appears logical if the activities can be structured to avoid the apparent conflict problems.

39. Griffin, A.G.S., "Sources of Capital: Merchant Banking - A Canadian Requirement?" Law Society of Upper Canada, Continuing Education Programme on Corporate & Securities Law, March 1972, p. K-1.

E. Need for Additional Capital

Purpose

4.45 It is apparent that the achievement of many of the objectives set out in paragraph 4.44 will require substantial infusions of capital during the next few years. The inability to obtain sufficient capital gives rise to particular dangers.

Protection of Clients

4.46 The public interest demands that a securities firm should be sufficiently well financed to avoid failure. It is true that increasingly comprehensive sets of safeguards have been devised and implemented by the Commission and the self-regulatory bodies under our jurisdiction to prevent such occurrences. Net free capital requirements have been reviewed. Audit and surveillance procedures have been tightened. This notwithstanding, a major brokerage bankruptcy occurred in Toronto during the summer of 1971. The circumstances of this bankruptcy are still under investigation. It is of some satisfaction to note that as the result of the establishment of the National Contingency Fund no public client will suffer a loss. It is also satisfying to recognize that such occurrences have been comparatively rare. However, dealers and other non-public clients who will claim as unprotected creditors will suffer from the bankruptcy mentioned above. Furthermore the investment dealer and broker community across Canada, which supports the National Contingency Fund, has in fact borne its pro rata share of the loss, reducing, or requiring an infusion of new capital. The Committee has no solution. Net free capital requirements may have to be raised to provide a bigger cushion. Contributions to the contingency

fund may have to be increased. Certainly each firm owes a duty to all others to be diligent to protect their joint interests by bringing unusual activities or patterns immediately to the attention of the appropriate authority so that the facts may be considered quickly and before failure occurs.

U.S. Brokerage Failures

4.47 By contrast the picture in the United States has been bleak. The Merrill Lynch-Royal brief⁴⁰ sets out a notice sent by the NYSE on July 23, 1971 to its members concerning the customer assistance program stating:

1. that over \$74,000,000 had been advanced or committed to liquidate liabilities of member firms which were in the course of or had completed liquidation;
2. that a further \$15,000,000 had been allocated for use in connection with an indemnification agreement relating to duPont, Glore Forgan; and
3. that the NYSE had raised an assessment of 3/8 of 1% of new commissions for transactions on or after July 1, 1971 to enable the Exchange to honour an indemnification agreement relating to the "failure" of Goodbody & Co., one of the largest American brokerage firms.

The TSE brief⁴¹ adds that in the past two years, four of the twenty largest U.S. firms in terms of net worth have failed, were required to be merged or suffered major difficulties leading to a complete change of control, and

40. Merrill Lynch, Pierce, Fenner and Smith, Inc. - Royal Securities Corp. Ltd., brief, pp. 24-25.

41. Submission of The Toronto Stock Exchange to the Ontario Securities Commission Industry Ownership Committee, p. 20.

that during the same period the NYSE found it necessary to intervene directly in the affairs of two hundred of its members, i.e. more than half of the NYSE members dealing with the public. The TSE brief suggests that these difficulties were due in part to the improvident use of capital, the failure of management to adequately control its business, and a method of financing through subordinated loans not permitted under the current Ontario regulations. The end result has been the passage of the Securities Investor Protection Act of 1971, which came into force in April, 1971. The plan, which has the backing of the U.S. treasury, received an initial \$75,000,000 with the power to borrow an additional \$1,000,000,000 from the U.S. Government. This is the apparent reason for the SEC's present concern with the effectiveness of U.S. self-regulatory bodies.

Implications of the Ontario Financial Profile

4.48 The financial profile discussed in paragraphs 4.27 through 4.42 coupled with our earlier conclusions makes it clear that additional and more permanent capital is needed by the securities industry if it is to achieve greater efficiency, provide broader advice and more effective service, particularly to attract institutional clients, and if it is to remain competitive in the national and international securities markets. Other more specific implications also emerged. Individual firms have given little attention to cost accounting principles although the TSE has recently introduced a cost accounting program to which about one-half of its members have voluntarily subscribed. Many firms in the securities industry, which in its research capacity is able to assess particular

businesses and industries using sophisticated business administration techniques, have not adopted these techniques in the administration of their own operations. To improve on this situation, to permit comparisons between and among firms, and to maintain and strengthen public confidence in the securities industry public disclosure of their financial statements by all securities firms (except mutual fund dealers, scholarship plan dealers, investment counsel and securities advisors) would be most valuable.

Conclusion: The Need for Outside Capital

4.49 For the reasons outlined in the previous paragraphs we find the conclusion irresistible that Ontario investment dealers, brokers, broker-dealers and securities dealers who qualify should be afforded access to other than the present sources of capital. The issues raised by this conclusion will be explained in the next chapter. While we find no similar need for other classes of registrant, we recommend no change in policy for mutual fund dealers whose sponsoring parent companies presently are permitted to be public companies.

PUBLIC CAPITAL IN THE SECURITIES INDUSTRY

The Present Position

5.01 While the Commission has never issued a specific prohibition against public financing of securities firms except for security issuers, the prohibition has been implicit in the form of application and screening which precedes the granting of registration. The Commission's continuing concern has been to ensure that control or substantial influence over registrants should not be obtained by disreputable or criminal elements. Thus the registration procedure extends the screening process to indirect sources of capital such as guarantors of loans. The object is that Ontario registrants should not become "fronts" through which an appearance of legitimacy is given to improper activities.

5.02 Certain exceptions to the general rule have been deliberately permitted in the case of certain mutual fund dealers. There are specific instances where the sponsoring parent of the mutual fund dealer or distribution company is itself a company whose securities are publicly owned, for example some of the insurance companies. More recently non-resident owned securities dealers, holding registration either through a controlled subsidiary or presently on a branch office basis¹ have distributed their securities in the United States.

1. By O. Reg. 337/71, s. 2 the non-resident owned parent firm must establish a subsidiary incorporated under the laws of Canada or one of the provinces before July 14, 1972.

Available Alternatives

5.03 Having concluded, in Chapter IV, that our dealers, in particular investment dealers, brokers, broker-dealers and securities dealers, should be permitted access to new sources of capital, yet remaining concerned to eliminate unwholesome influences, a consistent realization of these objectives must be attempted. The alternatives range from the present position, which generally speaking requires ownership and management to be in the same hands, to the proposal that capital may be sought wherever and through whatever methods are prescribed with no regard to who the actual owners are. It is implicit, whatever alternatives are adopted, that an even greater emphasis must be given in the registration procedures to an in depth examination of the character and experience of all officers and directors before outside capital is permitted.

5.04 Through the written submissions, the comments made in response to the questionnaire, and the discussions during the public hearings, three basic positions emerged. The first of these recommends no change from the existing policy: capital normally being provided only from the resources of those directly involved in the management of the firm. For the reasons set out in Chapter IV this is unacceptable. The second alternative, following the recommendations of the Moore and Joint Industry Committees, would permit the expansion of existing capital by two-thirds obtained from outside but "approved investors". The third alternative would permit the distribution of the dealer's securities to the public through a prospectus,

and the development of a normal after-market. A subsidiary question to be considered in connection with both of the latter alternatives is whether the dealer should be permitted to sell equity securities (voting or non-voting) to the outsiders or whether their investment would be confined to debt securities or some specific mix of both. We consider the principal submissions and recommendations in the paragraphs which follow.

The Toronto Stock Exchange

5.05 Both the TSE and IDA supported the conclusions reached by the Joint Industry Committee. The TSE position in summary was²:

- (1) Its members should be permitted to seek capital from "outside investors" through the sale of either debt or equity securities.
- (2) The sales should be subject to the safeguards and restrictions provided in the Moore Report³ which in summary are:
 - (a) no more than 40% of a firm's capital, including subordinated debt, should be held by outside investors;
 - (b) outside investors, with the exception of lending institutions making loans to dealers in the ordinary course of business, should be confined to "approved persons", who, with the exception of non-resident securities firms, would be individuals only with their approval being based upon the integrity of the individual and not his experience.

2. Op. cit., Ch. IV, footnote 16, pp. 7 and 8.

3. Op. cit., Ch. I, footnote 11, pp. 101-104.

- (c) the ratio of equity to debt would be a minimum of three dollars in equity for each dollar of subordinated debt capital;
- (d) the subordinated debt from the outside investor should be for a term of not less than two years;
- (e) outside investors at no time should hold more than 25% of the voting or participating securities and should not have the right to cast more than 25% of the votes at the election of directors;
- (f) no individual outside investor should hold more than 10% of the voting or participating securities in the firm; and
- (g) initially no more than 25 individuals should be approved as outside investors for any particular firm.

These conclusions were based on the premise that the proposal would satisfy any capital needs of which those Committees were aware.

Ontario District, Investment Dealers' Association of Canada

5.06 While supporting the Joint Industry Committee proposals (par. 5.05), the IDA made three specific sub-missions in addition⁴.

- (1) Professionalism is more important than capital to the effective performance of the securities industry. This professional "must be of competence and integrity, properly trained and prepared when necessary to subordinate his own interests to those of his clients."
- Any solution adopted should not be inconsistent with

4. Op. cit., Ch. IV footnote 17.

or restrict the further development of such standards.

- (2) Any rules adopted should give securities firms access to sources of sufficient capital to enable them to continue serving the economy, although the submission did conclude that "there was no aspect of industry activities where a major need for capital exists or can reasonably be expected to arise."
- (3) The Joint Industry Committee proposal would give access to significantly broader sources of capital without the irreversible change that would follow from the public distribution of freely transferable securities. It would therefore provide a period for experiment in which the merits of and need for outside ownership could be assessed followed by a further determination as to whether the rules could be relaxed or whether further restrictions should be imposed.

The IDA's concern was that the freer availability of sources of capital would detract from professionalism. It might permit persons who were not direct participants in the industry to demand control of the decision making councils of the firm or permit outside investors, unacquainted with the problems and standards of the industry to influence the decision makers.

Study on the Securities Industry in Quebec

5.07 The Interim Bouchard Report concluded⁵ that Quebec securities firms should have the easiest means of access possible to various sources of permanent capital, long term and short term, to assure their rapid and healthy financial growth. This conclusion is later reinforced⁶ by

5. Op. cit., Ch. II, footnote 7, p. 29.

6. Ibid, at p. 39.

the conclusion that the methods of obtaining capital should be enlarged to allow securities firms to distribute their securities to the public in accordance with standards to be established by the Quebec Securities Commission. In rejecting the conclusions of the Moore Report it found that they demonstrated "excessive prudence" and suggested that there was merit in the United States' rules⁷. The overwhelming thrust of these portions of the Report is to encourage and expand a strongly capitalized Quebec based securities industry capable of aggressively competing in both the national and international market place as well as serving the needs of Quebec.

Merrill Lynch, Pierce, Fenner & Smith, Incorporated:
Royal Securities Corporation Limited

5.08 This was by far the most extensive submission made by any individual member of the industry. The firm appeared at the public hearings and subsequently filed supplementary material. Its brief recommended⁸ that Ontario registrants should be permitted access to public capital on the same basis and subject to the same restrictions as members of the NYSE. Like the Bouchard Report it submitted that the Moore Report conclusions on the question of public ownership were erroneous⁹.

McLeod, Young, Weir & Company Limited

5.09 This was one of the largest of the Canadian based firms to support the recommendations for public ownership. It did so enthusiastically at the public hearings, obviously

7. Ibid, at pp. 66 to 72.

8. Submission by Merrill Lynch, Pierce, Fenner & Smith, Incorporated, and Royal Securities Corporation Limited to The Ontario Securities Commission Industry Ownership Study Committee, p. 1.

9. Ibid, at p. 33.

feeling that it has the size and history which would enable it under either the NYSE or the NASD standards to seek capital from the public. It argued that the capital needed by some securities firms could only come through broad based public distribution. It submitted that public ownership would militate against any suggestion that the industry is monopolistic since, as public companies, issuers would be required to comply with the usual continuing standard of disclosure concerning their affairs. It rebutted the concern evidenced by IDA regarding professionalism by comparing securities firms with banks, trust companies and insurance companies, noting that the latter were responsible financial intermediaries all of whom obtain capital from the public. During our public discussion of this firm's brief, it became apparent that the turnover question, and the price established in the market place for the shares based on a price:earnings ratio, were strong motivating factors in its support of public ownership.

New York Stock Exchange Rules

5.10 Since July, 1970 the members of the NYSE have been permitted to seek capital from the public under rules established by that Exchange and accepted, with some amendment, by the SEC. These comprehensive rules were summarized by the IDA in its brief and a copy of the IDA summary will be found as Appendix "I". The essential elements of these requirements are as follows.

Members are permitted to issue freely transferable common and preferred stock as well as debt securities. When one person becomes the beneficial owner of five per

cent or more of the voting stock, and he is not employed by the member, the shareholder must be approved by the Board of Governors. The majority of the directors must be professionals in IDA terms, i.e. insiders associated with the firm, while any outside directors must be approved by the Exchange. The issuer is prohibited from recommending the purchase of its own stock and may only execute unsolicited orders for its securities. In a rather comprehensive manner it prohibits directors of one firm or that firm itself from holding an interest in another firm unless the two firms are "merged" or through an underwriting, or unless the approval of the Exchange has been obtained. Debt to issued share capital must not exceed a 1 for 1 ratio. At least 25 per cent of the company's net worth, notwithstanding the ratio, must be attributable to voting stock. The primary business of the issuer must be either that of a broker or dealer in securities. The rules preclude the raising of new capital from the public for the purpose of retiring existing capital debt. Those persons who are shareholders at the time the company goes public may not sell, in total, more than 20 per cent of their shares in each of the two years following the public distribution. There is some residual discretion in the Exchange in most of these areas.

National Association of Securities Dealers' Rules

5.11 The NASD has permitted the public ownership of its member firms for some years. On May 8th, 1971 it circulated a proposal to its members to amend the then existing regulations in the belief "that there are certain conflicts of interest and other dangers to the public

interest inherent in ... public distribution of the securities issued by its member firms.". It states that, "conflicts properly regulated, however, are not contrary to the public interest.". A detailed explanation of the text of the proposed regulations accompanied the May 8th memorandum. On June 23rd, 1971 it issued a further memorandum noting that the Association's Board of Governors had modified the regulations to permit a member to underwrite its own securities and to participate in their distribution. This memorandum noted the critical need for permanent capital. It expressed concern about the inherent conflicts of interest and the lack of arms-length bargaining in establishing an offering price where a firm is its own underwriter. It continued:

"Many factors will go into this determination by the Association of whether the public interest is adequately protected. Among them will be the following: more strict requirements concerning certified financial statements than are required of ordinary offerings; the firm must have been in business for at least five years prior to the filing of its registration statement and three of the last five years must have been profitable; a majority of the Board of Directors of the firm must have been in the securities business for at least the immediate preceding five years; the firm's ratio of net capital to debt must be well below the ordinary requirements contained in the SEC rules which provide that a member's indebtedness cannot exceed 20 times the member's capital; the size of the offering can be no larger than 3 times the firm's net worth and the offering price must be established by the firm pursuant to recommendations made by two qualified independent underwriters represented by independent legal counsel. These firms must also meet the test of business history, management experience and financial soundness and would be allowed, though not required, to participate in the distribution of the securities. More stringent suitability standards would also be imposed and transactions in such securities could not be executed in a discretionary account without the prior written approval of the customer."

This letter represents some modification of the May 8th exposure draft, e.g. the offering permitted can be three times the net worth and not two times as in the May 8th draft¹⁰. The summary does clearly set out the six criteria which commend themselves to the authors of the Bouchard Interim Report¹¹.

The Questionnaire

5.12 The financial questionnaire sent to all Ontario registrants concluded by asking a number of questions, including the following,

"Is your firm in favour of securities firms in Canada being able to raise capital from the public in a broader and more flexible manner than that proposed by the Moore Report (pp. 100-104)?

Yes _____ No _____"

The response to this question, broken down by classes of registrant, is as follows:

	<u>Domestic</u>			<u>Foreign</u>		
	<u>Yes</u>	<u>No</u>	<u>Answer</u>	<u>Yes</u>	<u>No</u>	<u>Answer</u>
Investment						
Dealers	29	40	2	3	3	4
Brokers	0	4	2	1	0	0
Broker-dealers	2	22	4	0	0	0
Securities						
Dealers	3	3	2	2	0	4
Mutual Fund						
Dealers	6	1	13	1	0	6
Investment						
Counsel	4	5	11	0	2	4
Securities						
Advisers	0	2	0	0	0	0

We attach special significance to the response of investment dealers, since they tend to perform a wider range of functions in the securities markets than other categories of registrants and accordingly may be viewed,

10. NASD Memoranda to Members, dated May 8, 1971 and June 23, 1971. See also NASD Memorandum to Members, dated March 30, 1972, for a finalized version of the proposals.

11. Op. cit., Ch. II, footnote 7, at p. 69.

as a class, as having greater needs for capital. It will be noted that their response to the question was mixed. A significant minority of them (29) conclude that the Moore Report's guidelines on outside capital were too restrictive. The question must then be asked whether some of them should be precluded from the broader and more flexible methods of raising capital inherent in public distribution because some larger number of them (the majority of the members of the industry) believe the Moore guidelines are sufficient for the majority's needs. Of these twenty-nine resident owned firms, five are amongst the largest fifteen resident owned dealers.

Conclusions

5.13 We earlier concluded that certain classes of registrants will need substantial amounts of additional capital during the next five years, and certainly within the next decade, to meet the objectives thrust upon them. We have considered the argument, forcibly put, that the industry does not need any additional sources of capital and even if it does need additional sources of capital these can be adequately met by the Moore - Joint Industry Committee proposals. Against this argument we weighed a number of facts, including the following,

- (1) One Canadian owned and two U.S. controlled firms made representations through briefs and at the public hearing that public ownership was both necessary and desirable to provide the additional capital which each of these firms felt they needed and would need.
- (2) Twenty-nine of the seventy-one resident owned investment dealers who responded to the question in

the questionnaire, are in favour of being able to raise capital from the public in a broader and more flexible manner than that proposed by the Moore Report.

- (3) Without minimizing the economy's continuing need for foreign capital, in Chapter III we concluded that there is an increasingly greater need to attract the pools of Canadian savings to Canadian investment. The need of the Canadian economy for this resident generated capital requires a more amply and permanently financed securities industry to find and bring to market Canadian investment opportunities to which that capital will be attracted.
- (4) Major competitors, particularly those in the United States, have access to public capital not now available to our dealers. Quebec has indicated that it will permit Quebec based dealers to follow suit. Ontario based firms, operating or competing with the dealers in other jurisdictions, will be able to do so more effectively if they enjoy a similar freedom.
- (5) The objectives of competition, efficiency and innovation for the securities industry outlined in Chapter IV, coupled with the specific capital needs there considered, demonstrate that sources of capital beyond those proposed by the Moore Report are, in proper cases, both warranted and desirable.
- (6) The financial profile of securities firms discussed in paragraphs 4.27 through 4.42 illustrates the need for more share capital or long term debt capital and a lesser dependence upon subordinated loans. The easier access to capital will permit growth in the

smaller and medium sized firms and enable them to challenge the four to five firms which dominate certain sectors of the industry. The additional sources of capital will not only help to meet this need but will provide the cushion to maintain the health of the industry through cyclical changes in trading patterns.

- (7) With full public ownership the turnover problem is solved, subject to certain restrictions normal in the sale of control positions. The professional managers can sell in the event of need in the normal after-market. They can realize the fruits of their efforts if the after-market assesses the price of the shares on a price:earnings ratio instead of the book value now being used when a junior purchases the securities owned by his senior.

5.14 We agree with the submission made by IDA that the most important factor to be considered in a securities firm is "professionalism", that is, the expertise brought to bear by its managers. It is argued that to permit public ownership would permit outsiders unacquainted with the industry and not committed to it to influence a firm's activities. We are encouraged by the experience of the banking, insurance and trust companies in this regard. The only concern is that the professional manager might be subject to unhealthy influences. In the United States this fear has been catered for by requiring that any one achieving a five per cent interest in the firm must be approved by the regulatory authority. We have confidence that the self-regulatory organizations, in those areas

for which they have a direct concern, will set increasingly high standards for management and will ensure professionalism in the firm's activities through its personnel.

5.15 It was submitted that widespread public ownership of a securities firm would deter either the self-regulatory body or the public authority from using sanctions against the firm for fear of injuring the public shareholders. This problem, if such it be, exists today. One does not lightly suspend or cancel the registration of a major securities firm. To do so would result in punishment of numbers of innocent employees and prevent the firm from servicing its public clients. The action normally taken is against the individuals responsible in most cases and not the firm unless it is demonstrated that the conduct complained of so permeates the whole of the organization as to warrant the suspension or cancellation of the firm's registration. The Commission is called upon to make equally difficult decisions when it is requested to suspend trading or to deny exemptions. It is difficult to see that the problem would be any greater because the securities firms had distributed their securities to a large number of the public.

5.16 It was submitted that public ownership could lead to substantial concentration, that the big would get bigger and the small would be driven to the wall. The financial profile in paragraphs 4.27 to 4.42 makes it clear that although there are 62 registrants holding joint membership in the TSE and IDA (as well as other IDA members not members of the TSE), these being the two most senior self-regulatory organizations, the important sectors of the

industry are dominated by a relatively few firms at present. The need is for more firms of a larger size to compete with the dominant firms and to reduce the present concentration. Public ownership would permit medium sized firms to grow and compete with the larger firms. Some thought must be given to the small firms, which presently would not qualify by U.S. standards for public ownership, to permit them sources of additional capital through which they may expand into the medium size category. A small or medium size firm, financed by its professional owners-managers, could still enter the industry. No firm would be forced, of course, to seek outside sources of capital if its present owners were able to generate enough capital from their personal resources and were satisfied with its growth and potential. As the institutional investor becomes more and more important, it is equally important that there be firms available to service the individual small investor at prices he can afford to pay. It is probable that this service will be increasingly concentrated in the larger firms which, because of the economies of scale which their size gives them, are willing to compete for the business of the small investor.

5.17 Some confusion is injected into the consideration of public ownership by the suggestion that non-resident firms should be barred because in their home jurisdictions they have taken advantage of their right to go to the public for additional capital. Because Canadian firms do not wish to approach the public for funds it is suggested that non-resident firms which do so in their home jurisdictions should be barred here. However, if the basic fear is that non-

resident firms publicly financed in their home jurisdiction will use that capital to become dominant in Canada, surely one answer is to permit Canadian firms to obtain capital in a similar fashion in Canada and at least compete in a similar manner.

5.18 The conclusion of the Moore Report, supported in several of the submissions made to the Committee, that the industry is adequately capitalized to meet Canadian needs may be sanguine but not conclusive. The unofficial Gray Report and other economic studies considered by us suggest that the industry has not fulfilled these needs. We earlier concluded that additional capital is required in order that securities dealers meet the proposed objectives.

5.19 We are therefore convinced that there are numbers of significant benefits from additional capital. The access to public and permanent sources of capital will reduce the pressures resulting from the turnover problem. An influx of funds will provide a base for an increase in the size of securities firms. Greater sophistication in methods, equipment and management can be anticipated. Capital strength, size and efficiency will give rise to increased competition. The industry will be presented with opportunities for innovation, imagination and diversification. The public will have the opportunity to share directly in the risks and the rewards of the business. This involvement, and the dissemination of information through prospectus and continuous disclosure, will make the public more aware of the professional in the securities industry and will enable them to invest with greater confidence.

Recommendations

5.20 We recommend that investment dealers, brokers, broker-dealers and securities dealers should be permitted access to public capital as follows:

- (1) Those Ontario registrants which are able to meet the modified NYSE - NASD requirements detailed in Appendix "J" should be permitted to seek capital through sale of their securities to the public through a prospectus.
- (2) Those firms whose size or earnings records do not meet those standards for general public distribution should also be permitted access to sources of additional capital. We therefore recommend that they be permitted to raise outside capital from approved investors along the lines suggested by the Joint Industry Committee. The proposed rules are set out in Appendix "K".
- (3) Firms financing through a prospectus will become reporting companies under The Securities Act. Yearly and half-yearly financial statements will be published under present law. The same kind of financial disclosure should be required of firms raising outside capital according to the rules in Appendix "K" in order that any notion of competitive disadvantage might be dispelled. We further recommend that the audited financial statements now being prepared by all firms should be deposited by the Commission in its public files. This will remove any aura of mystery about particular firms and should enhance public confidence.
- (4) We received no submissions which lead us to believe that the same need for capital exists for mutual fund

dealers, scholarship plan dealers, investment counsel
and securities advisers. We make no recommendation with
respect to them.

NON-RESIDENT OWNERSHIP OF SECURITIES FIRMS

The Securities Industry: A Key Sector

6.01 The Watkins Report underlined the importance of the financial community to the economy¹. This has been emphasized in Ontario in a number of dramatic ways in recent years, with the result that Ontario evolved sophisticated securities and corporate legislation, regulation, and policies. The declaration of the Government of Ontario made by its Premier on July 13th, 1971 isolates the securities industry as a key sector.

Present Restrictions on Non-Resident Ownership

6.02 Following the Premier's statement the Government declared its concern by enacting regulations which prevented the registration of new firms or the take-over of existing registrants by restricting non-resident ownership to a maximum of 25%, while not more than 10% could be owned, directly or indirectly, by one person or his associates. Some latitude was permitted the Commission so that it had discretion to register new firms falling outside these limits, providing the Commission was of the view that the granting of such registration was not contrary to the public interest. The then Minister of Financial and Commercial Affairs, the Honourable Arthur Wishart, Q.C., in announcing the approval of the amendment to the non-resident regulation granting the Commission this discretion, stated,

1. Op. cit., Ch. II, footnote 10, at pp. 51-52.

"the number of firms involved is quite small and this discretionary power of the Securities Commission will be of help primarily to those firms affected during the transition period as the new regulations take effect. A few firms had been quite far along the line towards establishing themselves here when the policy on foreign ownership was changed."²

Existing non-resident owned firms were not affected by the new regulations unless there was a material change in their ownership³.

Purpose of Controls

6.03 The paramount concern which underlies this study is that the Canadian securities industry in general, and the Ontario securities firms in particular, should not become dominated by non-resident owned firms which may not be sympathetic to the needs of the Canadian economy. Our starting point is the spring of 1969, immediately prior to the sale of control of Royal Securities Limited to a non-resident. This take-over crystallized a concern which resulted in the immediate formation of the Moore Committee. A moratorium was declared on accepting new non-resident owned members by the self-regulatory bodies which sponsored the Moore Study. Their existing regulations did not contemplate their members raising capital from the general public. This latter understanding was breached when two of their United States members raised capital from the public in that country. So far as Ontario is concerned the

2. Bulletin of the Ontario Securities Commission, August, 1971, p. 98.

3. Regulation 794, s. 6a(3).

moratorium on non-resident ownership was reinforced by the regulation which the Ontario Government passed, albeit on an interim basis, pending the completion of this study. The object of the Ontario regulation was to provide a legal bulwark to prevent and control further inroads by non-residents. The Canadian securities industry could then focus on the larger problem, that of providing the capital required to obviate the general demand for foreign funds to finance the growth of our secondary industries and the development of our primary resources. It is the object of this phase of the Study to provide an interim solution in a provincial context. The long term solution must rest at the federal level through the use of Canada's fiscal and monetary systems and its determination of a national economic policy.

Possible Adverse Effects of Non-Resident Restrictions

6.04 We cannot be insensitive to the possibility that our suggested solutions might have the effect of leaving the securities industry in Ontario in splendid isolation and free of non-resident domination. While Ontario is presently an important financial centre, both in Canada and internationally, our recommendations must aim at supporting and not detracting from this fact. The position of Quebec was declared in the Interim Report of the Bouchard Committee and implemented in part by its subsequent action. British Columbia, Alberta and New Brunswick have each registered at least one non-

Canadian resident owned firm since July 13th, 1971⁴.

Manitoba, on the other hand, has stated its support for non-resident restrictions along the lines suggested in the Moore Report⁵. There have been no public manifestations of position from the other provinces.

The Formula - Restrictions on Ownership

6.05 Ontario adopted the formula of restricting non-resident ownership. It did so by limiting the percentage of capital which could be owned by non-residents. Our recommendations follow this precedent. It has the value of simplicity and clarity and has been used in a number of statutes⁶. Other methods of controlling the activities of non-residents are also possible. The Bouchard Interim Report suggests that rather than applying percentages, non-resident firms should be granted access to the Quebec market place, including membership in the Montreal and Canadian Stock Exchanges, and controlled by criteria to be established by the Quebec Securities Commission. That Commission may restrict the entry or activities of non-Quebec residents by establishing quotas and by taking into account the fields of activities of the non-

4. Since July 13, 1971 Quebec has registered a wholly-owned subsidiary of First Boston Corporation and a wholly-owned subsidiary of Morgan Stanley & Co. Inc. British Columbia, Alberta and New Brunswick have registered a wholly-owned subsidiary of First Boston Corporation. We have been advised by Saskatchewan, Manitoba, Prince Edward Island, Nova Scotia and Newfoundland that they have not registered any non-Canadian owned firm since July 13, 1971.

5. Toronto Star, February 2, 1971.

6. Op. cit., Ch. III, footnote 9, and also Canada Corporations Act, R.S.C. 1970, c. C-32. Telesat Canada Act, R.S.C. 1970, c. T-4. Canada Development Corporations Act, S.C. 1970-71, c.49. This formula has been used on two occasions by Ontario. See supra, Ch. I, footnote 16.

resident firms so that the Quebec market place and the Quebec stock exchanges will be controlled by Quebec firms⁷. Other specific solutions might include limiting the market share or percentage of profits available to non-resident owned firms.

6.06 While our terms of reference do not specifically request that we review the basic policy already established through the interim Ontario regulation, in the light of the conclusions in the Bouchard Interim Report rejecting the principle accepted here, and the subsequent acceptance of at least one non-resident firm by several provinces, we felt it important to reconsider the control technique previously adopted in Ontario. We have concluded that this is the fairest and most easily understood method of ensuring that control of the securities industry in Ontario remains substantially in the hands of Canadian residents. However, to ensure that an Ontario registrant is not substantially influenced through ownership by non-residents of non-voting shares or debt securities, we have decided that the 25%/10% maximum non-resident participation restriction should be applied to non-voting shares and debt securities as well as to voting shares.

Spectrum of Alternatives: Prior Existing Non-Resident Owned Registrants

6.07 At December 31st, 1971 there were 38 securities firms registered in Ontario in which the non-resident ownership exceeded the 25%/10% limits set out in the July regulations⁸. They enjoy the so-called "grandfather" status by virtue of the amended regulations. While it was not submitted that these firms should be forced to divest themselves immediately of their interests over the regulatory limits,

7. Op. cit., Ch. II, footnote 7 at p. 49.

8. The names of these firms are set out in Appendix "D".

representations have been made to us which would have this result ultimately.

6.08 Starting from the proposition that any new entrants must comply with the existing regulations, the spectrum of possibilities open to us commences with the proposal that existing firms be given continuing "grandfather status", i.e. that there would be no change in their status or limitation upon their ability to expand by importing capital from whatever sources are available to their owners. A second point of focus is limitation on market share. While no change would be imposed on either ownership or future increases in capital, the share of the market available to non-resident owned firms would be limited to a specified percentage of the market or to a specific maximum percentage of gross revenues in particular segments of the securities market. This would prevent these firms from expanding to dominance. A third alternative would be to grant complete "grandfather status" to firms whose gross trading in Canada is below a certain size, for example \$1 million dollars, with restrictions imposed if and when that limit is exceeded. The next alternative flows from the fact that by July 13th, 1972, the present activities of non-resident owned firms must be carried on through a Canadian subsidiary. It was submitted that such Canadian subsidiaries should not be permitted to expand by importing capital from abroad, or alternatively, that they should be restricted to the same sources of capital as are available to the Canadian owned firms⁹. The next suggestion is that a limit should be placed on the amount of capital the parent might

9. Ontario registrants are at present not permitted to "go public". See, supra, par. 5.01. If the recommendations of this Committee on this subject, as set out in Chapter V are accepted, this alternative would become pointless.

inject into its Canadian subsidiary coupled with a limit upon the earnings which might be retained by the subsidiary. The Joint Industry Committee proposed that this approach should apply to existing non-resident owned firms (if their parents did not raise capital from the public or their control did not change). Their capital would be frozen at the minimum net free capital requirement level of a recent fiscal year and they would be compelled to pay out 90% of net earnings in subsequent years, retaining only 10% to add to their capital base. The next approach is that of an enforced program of "Canadianization", over a specific period of time, leading to a reduction of non-resident ownership to the 25%/10% limits. Again the Joint Industry Committee suggested a specific application of this approach to non-resident owned firms whose parents had raised capital in a manner not available to resident owned firms, e.g. by public distribution. These firms would be required to initiate a roll-back distribution. They would be required to sell their equity according to a graduated timetable requiring 15% by 1974 and 75% by 1986 to be held by Canadians. At the same time these firms would have their capital frozen at the minimum net free capital level of a recent fiscal year but the requirement of a 90% yearly pay out of net earnings each year would be reduced by 1.2% for each 1% of equity acquired by Canadians. Any non-resident owned firm would be permitted to use this Canadianization formula to increase its capital beyond the capital freeze and retention of 10% of net earnings restriction described earlier. The final choice in the spectrum of alternatives, and the most drastic, would be to require an immediate sale by the non-residents in order to reduce their ownership to the acceptable limits. Without for a moment commenting on the mathematical formulae suggested, these encompass the range

of alternatives proposed through the submissions and reports made to us. In the paragraphs which follow we consider some of these in greater depth.

Merrill Lynch - Royal Brief

6.09 The brief does concede the Moore conclusion, that the securities industry is a "key sector" of the Canadian economy¹⁰. It notes the position advanced in an article published in August 1971 by Messrs. Feltham and Rauenbusch, which states,

"... as is the case with banking, key sector analysis does not lead automatically to the conclusion that there is no room for direct foreign investment. A limited foreign presence in the industry is desirable to ensure that the self-regulated securities industry maintains efficient operation by world standards. Moreover, outright limitation of foreign direct participation in the securities industry has serious regional economic implications."¹¹

The brief declares that the securities industry is not dominated by foreign firms. It submits that they have had a beneficial competitive effect and are in the public interest. It earlier stated,

"Governmental policy may dictate that further inroads by foreign investors into Canadian owned securities firms should be restricted

10. Op. cit., Ch. V, footnote 8, at p. 48.

11. Feltham, Ivan R. and William R. Rauenbusch, Multi-national Enterprises in Canada; Foreign-owned Enterprises in Canada, Osgoode Hall Law School, York University, Toronto, 1971, at p. 52.

to prevent domination....Present foreign investment ... should not be compulsorily expropriated. Further, there should be no restriction against foreign investors entering the Canadian securities industry directly provided no acquisition of a Canadian firm is involved."¹²

It rejects the Joint Industry Committee conclusion concerning compulsory Canadianization and the limits on the capital available to non-resident owned Ontario registrants. It adds that if public ownership is rejected "it is only reasonable" that foreign controlled firms, whose parents have access to public capital, should not be permitted to make the capital available to the Canadian subsidiary except to the extent necessary to comply with the "relevant legislative regulatory requirements".

The "Compromise" Proposals

6.10 During the course of and immediately following the public hearings, a series of what have been styled "compromise proposals" commenced to develop as follows:

(1) In its oral presentation on November 9th, 1971 Merrill Lynch met the submission that it was still in a position to dominate the industry through the use of retained earnings by making a proposal, which may be summarized as follows:

- (a) Non-resident owned firms' capital should be frozen at current levels;
- (b) If the Joint Industry Committee proposal that resident owned firms be permitted to increase

12. Op. cit., Ch. V, footnote 8, at p.1.

their capital from outside "approved investors" be accepted, then existing non-resident owned firms should also be permitted to increase their capital proportionately; and

- (c) Non-resident owned firms should be required to pay out by way of dividends to their parents the same percentage of net earnings in each fiscal year as the resident owned firms pay to their owners¹³.

- (2) On November 23rd, 1971 at the last public session, the TSE made a compromise proposal of its own, which may be summarized as follows¹⁴:

Non-resident firms should have their capital frozen as at a date prior to March 31st, 1971 and should not be permitted to increase that capital except in accordance with the following rules,

- (a) Each non-resident firm would be permitted to increase its capital beyond that established at the date of the capital freeze either from retained earnings or otherwise at a rate equal to the average rate of increase of capital by Canadian firms with the excess paid out by way of mandatory dividends,
- (b) Capital for these purposes would include both equity and debt, and
- (c) As an incentive to the non-resident owned firms to sell shares to Canadians, they would be granted an unlimited right to increase their

13. Transcript of the Public Hearings held by the Industry Ownership Study Committee, Volume III, November 16, 1971, p. 363, 1.26 and following.

14. Ibid., Volume IV, November 23, 1971, p. 474, 1.12 ff.

equity capital by sale of fully participating voting shares to Canadians on the same basis as Canadian firms.

(3) The Ontario District IDA supported the Canadianization or roll-back proposal made by the Joint Industry Committee. They asked for and were afforded an opportunity of responding to the proposals put forward by the TSE and Merrill Lynch. They submitted their comments under date of January 5th, 1972, the relevant conclusions of which were as follows:

- (a) The fiscal year chosen to establish a capital freeze should end not later than October 1st, 1971;
- (b) The capital freeze with retention of 10% subsequent net earnings proposed by the Joint Industry Committee should apply until such date as experience and study indicated that Canadian securities firms should be permitted to obtain capital from the public or in another manner significantly different from those presently permissible for such firms;
- (c) Subsequent to that date, each non-resident controlled firm should be permitted to increase its capital, as it then exists, either from retained earnings or otherwise, at a rate equal to the average rate of increase of capital by Canadian securities firms which are TSE or IDA members, with capital including loans as well as equities;
- (d) An alternative roll-back to that made in the Joint Industry Committee proposal should be implemented which would bring the non-resident

ownership down to 49% by 1986, rather than the 25% first proposed.

The Proposals Examined

6.11 The Merrill Lynch and the TSE "compromise proposals" at first blush appear similar. They both speak of a "capital freeze" with the former suggesting that it be at "current levels" while the latter would set it at "levels during a recent fiscal year ending prior to March 31, 1971". The basic distinction between the two proposals is that the TSE proposal uses capital as a base while the Merrill Lynch proposal uses net earnings as a base. In the TSE proposal the variable is the yearly increase in capital of the Canadian owned firms. Non-resident owned firms would be permitted to increase capital each year by the amount of that variable. In the Merrill Lynch proposal the variable is yearly pay out of a percentage of net earnings as dividends (or partners' remuneration) by the Canadian owned firms. Non-resident owned firms would be required to pay out as dividends each year that same percentage of their net earnings. The result is that, granting the superior efficiency that seems to be assumed for some non-resident owned firms, if such a firm earned 15% on gross revenue and the average earned by Canadian firms was 10% with the average pay out by Canadian firms being 50% of net earnings, the Merrill Lynch formula would require the non-resident owned firm to pay out 50% of the earnings as well, leaving a capital increase of 7.5% of gross revenues. Under the TSE proposal the non-resident owned firms would be permitted to retain only the average increase of capital realized by the Canadian firms, in this example only 5%, and would

therefore be forced to distribute the balance of 10%. In terms of the Merrill Lynch proposal this penalizes efficiency. In addition, Merrill Lynch submitted that the Canadian subsidiary of a non-resident owned firm, while deprived of access to capital from its parent, should be permitted to utilize the same public sources as Canadian controlled firms. The TSE proposal would not oppose this, providing that the offering was restricted to Canadians and was of fully participating voting shares in the subsidiary.

6.12 Many of the existing foreign controlled registrants have been in business in Canada for many years and have not, through their registration, contributed significantly to the Canadian economy. Their main role, until Merrill Lynch acquired control of Royal Securities, appears to have been to facilitate the trading by Canadians in foreign securities. There are large numbers of non-resident securities firms, particularly in the United States, that have raised money in their own jurisdictions for Canadian Governments at all levels and for Canadian corporations. There is no reason to believe that this inflow of capital, attracted to Canada on a sound business basis, will be affected by whatever policy is established in Ontario regarding ownership of securities firms.

The Activities of Foreign Owned Non-Registrants

6.13 Perhaps the even more startling observation which emerged as a result of the study is the evidence concerning the activities of U.S. broker-dealers in Canada. It is clear that many United States firms are trading in Ontario without registration. Their purpose no doubt is to facilitate trading by Canadian institutional investors.

This actively diverts into the U.S. market funds which might be put to good use in Canada. They are permitted this privilege so far as some of these institutional investors are concerned by the exemptions to the registration requirements found in Section 19(1)3 of The Securities Act. Similar exemptions are found in the majority of the other Canadian provinces. The fact that it is a problem is emphasized in the January 5th, 1972 submission of the IDA¹⁵. This had been preceded by a feature in the December 4th, 1971 issue of The Financial Post under the heading "Where The Money Goes"¹⁶. From a limited investigation it appears that the U.S. firms may be soliciting institutional investors who are not within the classes specified in Section 19(1)3 and in addition they may be distributing issues in Canada which in Ontario terms are being distributed to the public without a prospectus contrary to the provisions of Section 35. It should be noted that Section 19(3), coupled with Section 19(4), the private placement exemption, does permit solicitation of orders in size. However, we are informed by the Commission's staff that no forms 11 have been filed in accordance with the Act and its regulation reflecting the purchase of U.S. securities through either Section 19(1)3 or Section 19(3) and Section 58 in order to qualify for the exemptions from Section 35.

6.14 The Conway Study pointed up the fact that there are not enough medium and high grade Canadian securities to satisfy the growing demands of the institutional investor¹⁷.

15. Supplementary submission by the Ontario District of the Investment Dealers Association of Canada to the Ontario Securities Commission Industry Ownership Study, January 5, 1972.

16. Op. cit., Ch. IV, footnote 13.

17. Op. cit., Ch. III, footnote 11.

The institutional investors in many cases are confined by their governing legislation to certain qualities of securities. In any event, their money managers have responsibilities to the shareholders, policy holders, unit holders, and to the trust and pension fund beneficiaries. In order to satisfy these responsibilities some of the institutions, the mutual funds in particular, are investing substantial sums outside of the borders of Canada. In fairness it must be pointed out that this is really a "chicken and egg" proposition. The institutional money manager feels that he has a duty under certain circumstances to seek securities outside of Canada and that he is best served by the unregistered non-resident dealer. Therefore if there is no compulsion for the money managers to trade through Ontario registrants there will be no incentive for the Ontario securities firm to establish and maintain strong lines of business communication with foreign firms. This communication, as Merrill Lynch - Royal now advertises, includes the research information available through their parent and associated facilities.

Conclusion

6.15 We are of the view that the Bouchard Interim Report misdirects itself when it concludes that foreign firms who advance capital to establish their subsidiaries in business in Quebec will contribute to the Quebec economy. Past practice suggests the opposite. Permitting foreign branch offices, in effect, merely diverts business

originating in Canada from Canadian firms, which in turn reduces their ability to compete. Our objective is, in the recommendations being made in this chapter, to be as fair as is possible to existing non-resident controlled firms. We must be zealous to ensure that there is vital and innovative competition in the securities industry. To this end we do not believe it to be in the public interest to provide Ontario firms with protection from the innovative and efficient practices suggested for the existing foreign controlled firms. We are concerned, however, that the market place should not be dominated by foreign controlled firms. We wish to encourage and strengthen Canadian firms by permitting them to seek outside capital. In being fair to the existing non-resident firms, we wish to permit them to grow on a rational basis while at the same time guarding against their obtaining a position of undue dominance.

6.16 We have concluded that it would be unfair and unwarranted at the present time to require the compulsory roll-back suggested in either the Joint Industry Committee proposal or the alternatives suggested in the Ontario District, IDA submissions. We are recommending that a version of the "compromise proposals" be adopted. Having reached this conclusion we have sought a formula that was relatively simple and administratively workable. Our staff have tested the formula and have reported it administratively feasible. We have concluded also that amendments must be recommended to The Securities Act restricting trading by Ontario institutional investors with non-Ontario registrants and to this end are recommending amendments to the Act. We hope to encourage, with the assistance of the self-regulatory

bodies involved, the cross-fertilization process through which foreign securities firms are permitted to invest up to allowable limits in some Ontario registrants.

Recommendations

6.17 (1) The non-resident ownership restrictions should continue to apply to all classes of registrant.

(2) The present formula restricting the non-resident ownership in new applicants or the purchase of such an interest in existing registrants should be continued to restrict such ownership to a total of 25% held by non-residents with no more than 10% owned by any single non-resident or his associates. However the restriction of 25%/10% should not simply apply to voting shares but should also apply severally, in categories, to voting shares, non voting shares and debt securities.

(3) Where the non-resident owner is a firm which holds registration in a similar capacity in a foreign jurisdiction, and the Commission is of the view that the relationship facilitates reciprocal trading and research arrangements, subject to the approval of the Commission, the non-resident dealer and his associates may own up to 25% of the voting shares, or of the non voting shares or of the debt securities outstanding of the Ontario registrant, notwithstanding the 10% restriction recommended in (2).

(4) Any investor who is not an officer or director must be approved by the Commission when he achieves 5% ownership of any class of any outstanding securities of a firm distributing its securities to the public under the rules in Appendix "J" and when he achieves 5% ownership of the outstanding voting shares of a firm distributing its securities to limited outside investors under the rules in Appendix "K".

(5) Firms whose ownership presently exceeds the allowable non-resident limits (styled "non-resident controlled firms") will be permitted to retain that registration upon the following conditions:

- (a) There is no material change in the ownership of the non-resident controlled firm, either direct or indirect. A material change in ownership will include not only ownership in the Ontario registrant but ownership in any firm which may itself directly or indirectly control capital in the registrant.
- (b) Where such a material change in ownership takes place in the absence of approval by the Commission, the non-resident owners will be required to divest themselves of sufficient of that capital investment to reduce their holdings to the limits set for new applicants.
- (c) Subject to the restrictions on capital detailed below, where the non-resident controlling firm is itself a public company and as such wishes to raise additional capital from the public, application must be made to the Commission for a ruling as to whether that distribution would result in a material change in control.
- (d) With the purpose of permitting the non-resident controlled firm to increase its capital in accordance with the formula set out below, a "base

capital" must be established for each such firm. For this purpose it may be established at the highest level achieved by that firm for any fiscal year ending on or before March 31, 1971.

- (e) Where the non-resident firm has traded in Ontario through a branch office operation prior to March 31, 1971 and for the purpose of continued registration has incorporated a Canadian federal or provincial company, the auditors must establish a "base capital" for the new company based upon the premise that the branch office operations were carried on through a separate corporation prior to March 31, 1971 with the base capital so established being subject to the approval of the Commission.

- (f) For the purpose of comparisons, the Commission has established a "domestic base capital" which was arrived at by averaging the capital of the 13 Canadian owned securities firms recognized by the Bank of Canada as "money market dealers", as at March 31, 1971. Changes in domestic base capital will be established through the averaging of the capital changes in the domestic money market dealers of the next twelve month period, e.g. March 31, 1972, March 31, 1973, etc.

- (g) Using the domestic base capital changes a non-resident firm would be permitted to increase its base capital, either from retained earnings or the infusion of capital, by the percentage the domestic base capital calculated as at March 31, 1972, has increased over the domestic base capital

for the year ending March 31, 1971. The firm must pay out any excess earnings to its shareholders. The same procedure will be followed in each subsequent year.

- (h) Where the non-resident controlled firm wishes to sell voting and fully participating common shares to Canadian residents in accordance with the terms laid down for domestic firms as recommended in the previous chapter, the capital so obtained may be added to the base capital for the purpose of computing the base on which the allowable percentage increases in capital derived from retained earnings or other sources is taken.
- (i) The non-resident controlled firm will be required to pay by way of dividend to its parent and other shareholders at least the same percentage dividend that the parent company pays to its shareholders where such net earnings are available.

(6) Where a non-resident controlled firm is demonstrated to be in violation of any of the conditions of its registration, and in particular those involving a material change in ownership or capital growth, The Securities Act should be amended to permit the Commission to declare the firm to be in violation of the condition of registration, in which case the Commission may, in lieu of cancelling or suspending the registration, have the right to apply to the Court to place the registration in trusteeship pending sale of sufficient of the capital to Canadian residents to bring it within the 25%/10% rules or until

the capital position is rectified¹⁸.

(7) Where the non-resident controlled firm falls below its base capital, and in particular below the minimum net free capital required from time to time of all registrants pursuant to the regulations, the owners of the company will be permitted to inject new capital by way of a subordinated loan in order to bring it up to the appropriate level. We see no inequity in permitting the firm to raise this loan at the cheapest rate possible and a guarantee by the non-resident owner would also be permitted.

(8) We recommend that the exemptions in Section 19(1)3 and Section 19(3) be amended to provide that where an intermediary is involved in a trade in Ontario that intermediary must be an Ontario registrant.

(9) We recommend that the role of the institutional investor disclosed in these enquiries be brought to the attention of the appropriate authorities, i.e. the Superintendents of Insurance and Registrars of Loan and Trust Companies in the Province, the Federal Inspector of Banks and Superintendent of Insurance, in order that they might consider whether they would wish to insist that their licencees or registrants obtain the benefit of the protection now available in provincial laws when the trading is done through provincial registrants.

18. This right to apply to the Court could be similar to the right now found in section 27 of The Securities Act.

CHAPTER VII

SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

Chapter I - Introduction and Chapter II - Related Studies and Reports

7.01 Chapters I and II discuss the terms of reference, background of the principal issues and the methods used in this study and other related studies and reports made in recent years.

Chapter III - Canadian Capital Requirements

7.02 To arrest the export of savings by institutional investors and simultaneously to encourage wider distribution of Canadian equity securities to Canadians, it is the clear task of government and the securities industry, with the aid of the institutional investor, to develop and encourage a more broadly based Canadian equity market. In pursuing this objective it is important to recognize that a substantial volume of the trading of the larger Canadian public companies presently takes place outside of Canada.

7.03 The institutional investor is growing in importance, both with regard to mobilization of savings and activity in the securities market. As this occurs, the role of the individual investor diminishes, and it appears that this trend is irreversible. Yet the individual remains important in establishing liquidity and current market prices. The Canadian securities industry is following the example currently under critical discussion in the United States and is becoming increasingly concerned with the requirements of institutions. At the same time the Canadian industry continues to recognize the importance of the small investor. If it fails in this endeavour the individual will effectively be denied direct access to the market place.

7.04 Canadians have traditionally shown a relatively high rate of personal saving. At the same time, to meet the capital needs of a rapidly expanding economy, we have depended on foreign capital. This may not be as readily available. It is clear that there will be a continued demand for capital. The trend is away from individual saving and into pooled savings through institutions. Our object then is to ensure that the Canadian securities industry will be adequately capitalized. Thus it will be properly equipped to encourage and facilitate the optimum investment of Canadian savings, efficiently allocating domestic capital to Canadian needs.

Chapter IV - The Securities Industry in Ontario

7.05 We find the conclusion irresistible that Ontario investment dealers, brokers, broker-dealers and securities dealers who qualify should be afforded access to other than the present sources of capital. While we find no similar need for other classes of registrant, we recommend no change in policy for mutual fund dealers whose sponsoring parent companies presently are permitted to be public companies.

Chapter V - Public Capital in the Securities Industry

7.06 We are convinced that there are numbers of significant benefits from additional capital. The access to public and permanent sources of capital will reduce the pressures resulting from the turnover problem. An influx of funds will provide a base for an increase in the size of securities firms. Greater sophistication in methods, equipment and management can be anticipated. Capital strength, size and efficiency will give rise to increased competition.

The industry will be presented with opportunities for innovation, imagination and diversification. The public will have an opportunity to share directly in the risks and rewards of the business. This involvement, and the dissemination of information through prospectus and continuous disclosure, will make the public more aware of the professional in the securities industry and will enable them to invest with greater confidence.

7.07 We recommend that investment dealers, brokers, broker-dealers and securities dealers should be permitted access to public capital as follows:

- (1) Those Ontario registrants which are able to meet the modified NYSE - NASD requirements detailed in Appendix "J" should be permitted to seek capital through sale of their securities to the public through a prospectus.
- (2) Those firms whose size or earnings records do not meet those standards for general public distribution should also be permitted access to sources of additional capital. We therefore recommend that they be permitted to raise outside capital from approved investors along the lines suggested by the Joint Industry Committee. The proposed rules are set out in Appendix "K".
- (3) Firms financing through a prospectus will become reporting companies under The Securities Act. Yearly and half-yearly financial statements will be published under present law. The same kind of financial disclosure should be required for firms raising outside capital according to the rules in Appendix "K" in order that any notion of competitive disadvantage might be dispelled. We further recommend that the audited financial statements now being prepared by all firms should be deposited by the Commission in its public

files. This will remove any aura of mystery about particular firms and should enhance public confidence.

- (4) We received no submissions which lead us to believe that the same need for capital exists for mutual fund dealers, scholarship plan dealers, investment counsel and securities advisers. We make no recommendation with respect to them.

Chapter VI - Non-Resident Ownership of Securities Firms

7.08 Our objective is to be as fair as is possible to existing non-resident controlled firms. We must be zealous to ensure that there is vital and innovative competition in the securities industry. To this end we do not believe it to be in the public interest to provide Ontario firms with protection from the innovative and efficient practices suggested for the existing foreign controlled firms. We are concerned, however, that the market place should not be dominated by foreign controlled firms. We wish to encourage and strengthen Canadian firms by permitting them to seek outside capital. In being fair to the existing non-resident firms, we wish to permit them to grow on a rational basis while at the same time guarding against their obtaining a position of undue dominance.

7.09 We have concluded that it would be unfair and unwarranted at the present time to require the compulsory roll-back suggested in either the Joint Industry Committee proposal or the alternatives suggested in the Ontario District, IDA submissions. We are recommending that a version of the "compromise proposals" be adopted. Having reached this conclusion we have sought a formula that was relatively simple and administratively workable. Our staff

have tested the formula and have reported it administratively feasible. We have concluded also that amendments must be recommended to The Securities Act restricting trading by Ontario institutional investors with non-Ontario registrants and to this end are recommending amendments to the Act. We hope to encourage, with the assistance of the self-regulatory bodies involved, the cross-fertilization process through which foreign securities firms are permitted to invest up to allowable limits in some Ontario registrants.

7.10 We recommend that:

(1) The non-resident ownership restrictions should continue to apply to all classes of registrant.

(2) The present formula restricting the non-resident ownership in new applicants or the purchase of such an interest in existing registrants should be continued to restrict such ownership to a total of 25% held by non-residents with no more than 10% owned by any single non-resident or his associates. However the restriction of 25%/10% should not simply apply to voting shares but should also apply severally, in categories, to voting shares, non voting shares and debt securities.

(3) Where the non-resident owner is a firm which holds registration in a similar capacity in a foreign jurisdiction, and the Commission is of the view that the relationship facilitates reciprocal trading and research arrangements, subject to the approval of the Commission, the non-resident dealer and his associates may own up to 25% of the voting shares, or of the non voting shares or of the debt securities outstanding of the Ontario registrant, notwithstanding the 10% restriction recommended in (2).

(4) Any investor who is not an officer or director must be approved by the Commission when he achieves 5% ownership of any class of any outstanding securities of a firm distributing its securities to the public under the rules in Appendix "J" and when he achieves 5% ownership of the outstanding voting shares of a firm distributing its securities to limited outside investors under the rules in Appendix "K".

(5) Firms whose ownership presently exceeds the allowable non-resident limits (styled "non-resident controlled firms") will be permitted to retain that registration upon the following conditions:

- (a) There is no material change in the ownership of the non-resident controlled firm, either direct or indirect. A material change in ownership will include not only ownership in the Ontario registrant but ownership in any firm which may itself directly or indirectly control capital in the registrant.
- (b) Where such a material change in ownership takes place in the absence of approval by the Commission, the non-resident owners will be required to divest themselves of sufficient of that capital investment to reduce their holdings to the limits set for new applicants.
- (c) Subject to the restrictions on capital detailed below, where the non-resident controlling firm is itself a public company and as such wishes to raise additional capital from the public, application must be made to the Commission for a ruling as to whether that distribution would result in a material change in control.
- (d) With the purpose of permitting the non-resident

controlled firm to increase its capital in accordance with the formula set out below, a "base capital" must be established for each such firm. For this purpose it may be established at the highest level achieved by that firm for any fiscal year ending on or before March 31, 1971.

(e) Where the non-resident firm has traded in Ontario through a branch office operation prior to March 31, 1971, and for the purpose of continued registration has incorporated a Canadian federal or provincial company, the auditors must establish a "base capital" for the new company based upon the premise that the branch office operations were carried on through a separate corporation prior to March 31, 1971, with the base capital so established being subject to the approval of the Commission.

(f) For the purpose of comparisons, the Commission has established a "domestic base capital" which was arrived at by averaging the capital of the 13 Canadian owned securities firms recognized by the Bank of Canada as "money market dealers", as at March 31, 1971. Changes in domestic base capital will be established through the averaging of the capital changes in the domestic money market dealers of the next twelve month period, e. g. March 31, 1972, March 31, 1973, etc.

(g) Using the domestic base capital changes a non-resident firm would be permitted to increase its base capital, either from retained earnings or the infusion of capital, by the percentage the domestic base capital, calculated as at March 31, 1972, has

increased over the domestic base capital for the year ending March 31, 1971. The firm must pay out any excess earnings to its shareholders. The same procedure will be followed in each subsequent year.

(h) Where the non-resident controlled firm wishes to sell voting and fully participating common shares to Canadian residents in accordance with the terms laid down for domestic firms as recommended in the previous chapter, the capital so obtained may be added to the base capital for the purpose of computing the base on which the allowable percentage increases in capital derived from retained earnings or other sources is taken.

(i) The non-resident controlled firm will be required to pay by way of dividend to its parent and other shareholders at least the same percentage dividend that the parent company pays to its shareholders where such net earnings are available.

(6) Where a non-resident controlled firm is demonstrated to be in violation of any of the conditions of its registration, and in particular those involving a material change in ownership or capital growth, The Securities Act should be amended to permit the Commission to declare the firm to be in violation of the condition of registration, in which case the Commission may, in lieu of cancelling or suspending the registration, have the right to apply to the Court to place the registration in trusteeship pending sale of sufficient of the capital to Canadian residents to bring it within the 25%/10% rules or until the capital position is rectified.

(7) Where the non-resident controlled firm falls below its base capital, and in particular below the

minimum net free capital required from time to time of all registrants pursuant to the regulations, the owners of the company will be permitted to inject new capital by way of a subordinated loan in order to bring it up to the appropriate level. We see no inequity in permitting the firm to raise this loan at the cheapest rate possible and a guarantee by the non-resident owner would also be permitted.

(8) We recommend that the exemptions in Section 19(1)3 and Section 19(3) be amended to provide that where an intermediary is involved in a trade in Ontario that intermediary must be an Ontario registrant.

(9) We recommend that the role of the institutional investor disclosed in these enquiries be brought to the attention of the appropriate authorities, i. e. the Superintendents of Insurance and Registrars of Loan and Trust Companies in the Province, the Federal Inspector of Banks and Superintendent of Insurance, in order that they might consider whether they would wish to insist that their licencees or registrants obtain the benefit of the protection now available in provincial laws when the trading is done through provincial registrants.

APPENDIX "A"

Submissions to the Industry Ownership Study Committee of
the Ontario Securities Commission.

1. Bache & Company, per Mr. Stanley F. Klimczak,
Executive Vice President.
- 1A. A further submission by Bache & Company.
2. Mr. P.W. Bishop, Toronto, Ontario.
3. The Canadian Mutual Funds Association, per Mr.
A.D. Johnstone, President.
4. Corporate Investors (Marketing) Limited and Loomis,
Sayles & Company (Canada) Limited.
5. Dean Witter International Incorporated, per Mr.
Bruce A. Gordon, Vice-President.
6. Drexel Firestone (Canada) Limited, per Mr. H.L.
Hebring, Director.
7. Harris and Partners Limited, per Mr. W.B. Harris,
President.
8. Investment Dealers' Association, Ontario Section.
- 8A. Supplementary submission of January 5, 1972 of the
Investment Dealers' Association of Canada.
9. Laidlaw & Company Incorporated, per Mr.E.W. Jones,
Vice-President.
10. McLeod, Young, Weir & Company Limited, per Mr. G.C.
MacDonald, President.
11. Merrill, Lynch, Pierce, Fenner & Smith, Incorporated
and Royal Securities Limited.
- 11A. Merrill, Lynch, Pierce, Fenner & Smith, Incorporated
and Merrill Lynch, Royal Securities Limited,
Ontario Securities Industry: Prospects and Problems.
Basic Economic Considerations for the 1970's.
12. Metropolitan Life Insurance Company.
13. Scudder, Stevens and Clark of Canada Limited, per
Mr. J.S. Clark, Vice-President, and Mr. L.W. Skey,
General Manager and Treasurer.
14. The Toronto Stock Exchange.
- 14A. Addendum to the Submission of the Toronto Stock
Exchange.
- 14B. The trading position of Merrill Lynch, Royal
Securities on the Toronto Stock Exchange.
- 14C. Brief submitted by the Toronto Stock Exchange to a
meeting between Ontario Government Representatives
and the Board of Governors of the Toronto Stock
Exchange, January 17, 1972.

15. United Funds Management Limited, per Mr. J.B. Prendergast, President and Chief Executive Officer.
16. The Prudential Insurance Company of America and Prudential Fund Management of Canada Limited, per Mr. Floyd H. Bragg, President, Canadian Operations.
17. Mr. Philip Anisman, Ottawa, Ontario.
- 17A. A paper attached to the submission of Mr. Anisman.
18. The Canadian Life Insurance Association, per Mr. J.A Tuck
19. The Dominion Trust Company, per Mr. Carl Rosen.
20. duPont, Glore, Forgan Incorporated, per Mr. Harold A. Rousselot, Chairman.
21. Lafferty, Harwood & Partners Limited, per Mr. R.G.D. Lafferty.
22. Mr. W.E. Cowie, Ottawa, Ontario.
23. Pope & Company, per Mr. Joseph Pope.
24. Messrs. John G. Doherty and Timothy Pritchard, Montreal, Quebec.



555 YONGE STREET
TORONTO 284, ONTARIO

ONTARIO SECURITIES COMMISSION

October 8, 1971

Dear Sirs: Re: O.S.C. Industry Ownership Study

As you are aware the Commission Committee, as requested by the Honourable the Prime Minister of Ontario, is examining the questions raised by non-resident and public ownership. The terms of reference we have set for ourselves may be found in our Weekly Summary for the week ending September 10th, 1971. Additional information concerning this study and its background will also be found in the summaries for the weeks ending July 16th, July 26th and August 6th.

In order that we may have facts upon which to reach conclusions the enclosed questionnaires were designed. We would ask you to complete one copy and return it to us not later than November 5th, 1971.

The information supplied by you will be kept confidential so far as the Commission is concerned. It will be analyzed and may be included as part of the collective statistical information upon which the ultimate report is based. It will be published in such a form that the returns of individual registrants will not be identified.

We have received and welcome briefs or comments from individual firms. So far as possible they should be submitted prior to our public hearing on October 26th. They should be marked confidential if that is your wish. Any additional comment may be enclosed with the return of this questionnaire and will be viewed as confidential unless otherwise designated.

Your thoughtful assistance in answering the questions will be of great value to the study.

Yours very truly,

H. S. Bray
H. S. Bray, Q.C.
Study Director
(129)

ONTARIO SECURITIES COMMISSION INDUSTRY OWNERSHIP STUDY

QUESTIONNAIRE

General Information

Designate whether firm is corporation, partnership,

sole proprietorship, or other

Number of offices

Number of offices outside Canada

Total number of employees (including shareholders/partners)

Number of licensed salesmen (including shareholders/partners)

Number of shareholders/partners

Category(ies) in which registration is held

(check off)

broker

broker-dealer

investment dealer

mutual fund dealer

scholarship plan dealer

securities dealer

security issuer

adviser - investment counsel

adviser - securities adviser

underwriter

Instructions

1. The financial information required should be prepared on a consolidated basis, i.e. it should include subsidiaries, including United States subsidiaries. Where some part of the business, e.g. the stock exchange business, is carried on by an associate firm that is not a subsidiary (e.g. a partnership) a separate questionnaire should be completed for each of such firms. Additional copies of the questionnaire should be completed for each of such firms. Additional copies of the questionnaire are available from the Ontario Securities Commission, Office of the Vice Chairman (365-2861).
2. Information is to be shown in thousands of dollars. For example, an amount of \$5,962,300 would be shown as \$5,962.
3. Please do not add additional captions for the statements. Include items not specifically provided for on statements under "other" and if you think necessary, report separately any unusual items included under that caption. If you do not have the figures broken down as required by the statements, please make as close an approximation as possible.
4. Investment counsel and securities advisers exclusively registered as such will not answer the clearly inapplicable questions.
5. Inquiries: Mr. S. Gorecki, C.A., Financial Analyst, 365-6558
Mrs. D.A. Stafl, Economist 365-5151

I. Balance sheet information as at end of fiscal year ended between April 1, 1970 and March 31, 1971

Specify date of year end

\$ Thousands

- | | |
|------------------------------------------------------------------------------------------------------------------------|-------|
| 1. Total Assets | _____ |
| <u>Liabilities</u> | |
| 2. Call loans and bank overdrafts | _____ |
| 3. All other liabilities | _____ |
| 4. Total liabilities | _____ |
| <u>Capital and Surplus</u> | |
| 5. Share capital/partnership capital | _____ |
| 6. Surplus or undivided profits | _____ |
| 7. Reserves | _____ |
| 8. Subordinated loans-shareholders/partners | _____ |
| 9. Other | _____ |
| 10. Total (Items 5 - 9 inclusive) | _____ |
| 11. Total liabilities and capital (Items 4 + 10)
(should agree with Item 1 above) | ===== |
| 12. Contingent liabilities (e.g. Guarantees) | _____ |
| 13. Stipulate sources of potential capital and amount
(e.g. bank line of credit, guarantees, etc.)
Sources _____ | _____ |

Information with respect to income for financial year ended between April 1, 1970 and March 31, 1971

\$ Thousands

- | | |
|---------------------------------------------------------------------------------------------|-------|
| 1. Total gross income | _____ |
| 2. Total expenses (excluding all remuneration to
shareholders/partners and income taxes) | _____ |
| 3. Shareholders/partners' remuneration | _____ |
| 4. Income taxes (only if an incorporated company) | _____ |
| 5. Total of Items 2, 3 and 4 | _____ |
| 6. Net income (Item 1 less Item 5) | _____ |

II. Changes in Capitalization
Capital/Proprietorship
Subordinated Loans

\$ Thousands	For fiscal year ended between						
	Apr 1/64 Mar 31/65	Apr 1/65 Mar 31/66	Apr 1/66 Mar 31/67	Apr 1/67 Mar 31/68	Apr 1/68 Mar 31/69	Apr 1/69 Mar 31/70	Apr 1/70 Mar 31/71
Balance (at beginning of period)							
(a) capital							
(b) Subordinated Loans							
Additions:							
(a) capital							
(b) Subordinated Loans							
Withdrawals:							
(a) capital							
(b) Subordinated Loans							
Balance (at end of period)							
(a) capital							
(b) Subordinated Loans							

(I. Income and Expense Information

\$ Thousands

	For fiscal year ended between						
	Apr 1/64 Mar 31/65	Apr 1/65 Mar 31/66	Apr 1/66 Mar 31/67	Apr 1/67 Mar 31/68	Apr 1/68 Mar 31/69	Apr 1/69 Mar 31/70	Apr 1/70 Mar 31/71
Income:							
Brokerage Commissions:							
Institutions							
Retail							
Other							
Total							
Profits (Losses) on							
Trading							
Profits (Losses) on							
Underwriting							
Interest & Dividends							
Other							
(f) Total Income							
Expenses:							
Remuneration to							
Employees:							
Sales & Trading							
Accounting Operation							
Total							
Research							
Expenditures							
Commission to other							
Brokers							
Communications							
Occupancy & Equipment							
Promotional							
Other							
(f) Total Expenses							
(f) Income before							
Shareholders/partners							
Remuneration (a-b)							
Shareholders/part-							
ners remuneration:							
Salaries							
Bonuses & Dividends							
Any other							
(f) Total							
(f) Income Taxes							
(if incorporated)							
Net Income (c-d-e)							

IV. Total commissions earned for your firm in each of your last 7 financial years ended between:

\$ Thousands	Apr 1/64 Mar 31/65	Apr 1/65 Mar 31/66	Apr 1/66 Mar 31/67	Apr 1/67 Mar 31/68	Apr 1/68 Mar 31/69	Apr 1/69 Mar 31/70	Apr 1/70 Mar 31/71
(a) Commissions on U.S. equity securities traded for Canadian residents through Canadian offices							
(b) Commissions on U.S. debt securities traded for Canadian residents through your Canadian offices							
(c) Commissions on Canadian equity securities traded for U.S. residents on orders from your U.S. offices							
(d) Commissions on Canadian debt securities traded for U.S. residents on orders from your U.S. offices							
(e) Commissions on Canadian equity securities traded for Canadian residents through Canadian offices							
(f) Commissions on Canadian debt securities traded for Canadian residents through Canadian offices							
TOTAL							

V. Which of the following roles or functions does your firm presently perform (as described in the Moore Report pp. 21-25)

Advisory	_____	
Brokerage	_____	
(a) Margin Facility	_____	_____
Dealer	_____	
Merchant Banker	_____	
Money Market	_____	
Underwriting	_____	

(a) Approximately what percentage of total gross income was derived from each function in the financial year ending:

	<u>Mar.31/66</u>	<u>Mar.31/69</u>	<u>Mar.31/71</u>
Advisory	_____	_____	_____
Brokerage	_____	_____	_____
(a) Margin Facility	_____	_____	_____
Dealer	_____	_____	_____
Merchant Banker	_____	_____	_____
Money Market	_____	_____	_____
Underwriting	_____	_____	_____
Total	100%	100%	100%

(b) Approximately what percentage of total net income was derived from each function in the financial year ending:

	<u>Mar.31/66</u>	<u>Mar.31/69</u>	<u>Mar.31/71</u>
Advisory	_____	_____	_____
Brokerage	_____	_____	_____
(a) Margin Facility	_____	_____	_____
Dealer	_____	_____	_____
Merchant Banker	_____	_____	_____
Money Market	_____	_____	_____
Underwriting	_____	_____	_____
Total	100%	100%	100%

(c) Approximately what percentage of your total capital on average was required to support each function in the financial year ending:

	<u>Mar.31/66</u>	<u>Mar.31/69</u>	<u>Mar.31/71</u>
Advisory	_____	_____	_____
Brokerage	_____	_____	_____
(a) Margin Facility	_____	_____	_____
Dealer	_____	_____	_____
Merchant Banker	_____	_____	_____
Money Market	_____	_____	_____
Underwriting	_____	_____	_____
Total	100%	100%	100%

- (d) Which of these functions do you anticipate will change in terms of total gross income in the future? (Write in "Grow" or "Decrease" or "No change")

	<u>Next 2 years</u>	<u>Next 10 years</u>
Advisory	_____	_____
Brokerage	_____	_____
(a) Margin Facility	_____	_____
Dealer	_____	_____
Merchant Banker	_____	_____
Money Market	_____	_____
Underwriting	_____	_____

- (e) What percentage of capital do you anticipate will be required to perform each of these functions in the future:

	<u>Next 2 years</u>	<u>Next 10 years</u>
Advisory	_____	_____
Brokerage	_____	_____
(a) Margin Facility	_____	_____
Dealer	_____	_____
Merchant Banker	_____	_____
Money Market	_____	_____
Underwriting	_____	_____
Total	100%	100%

- (f) In which functions, if any, have you had to refuse business within the past three years due to inadequate capital: (Answer "yes" or "no").

Advisory	_____
Brokerage	_____
(a) Margin Facility	_____
Dealer	_____
Merchant Banker	_____
Money Market	_____
Underwriting	_____

Give brief details for "yes" answers.

- (g) Would that capital be available to you under the Moore Report proposals? (See pp.100 - 104 of Moore Report).

Yes _____ No _____

VI. (a) Do you anticipate that you might use any of the Moore Report's new sources of capital assuming they are approved? _____

(b) If so, which ones? _____

(c) If so, by what percentage will your capitalization increase? _____

II. Is your firm sufficiently capitalized to perform the underwriting function at present? _____

Yes _____ No _____

(a) How many underwritings, not including private placements, did your firm participate in as part of the originating banking or selling group, as described in the Moore Report, pp. 22-23, in each of the past 7 years?

Type of Issuer	For fiscal year ended between						
	Apr 1/64 Mar 31/65	Apr 1/65 Mar 31/66	Apr 1/66 Mar 31/67	Apr 1/67 Mar 31/68	Apr 1/68 Mar 31/69	Apr 1/69 Mar 31/70	Apr 1/70 Mar 31/71
Government							
Finance Co.							
Industrial							
Investment Co.							
Mining							
Mutual Fund							
Total							

(b) What was the total dollar amount (in thousand dollars) you were committed to take of these underwritings for each of the past 7 years?

Type of Issuer	For fiscal year ended between						
	Apr 1/64 Mar 31/65	Apr 1/65 Mar 31/66	Apr 1/66 Mar 31/67	Apr 1/67 Mar 31/68	Apr 1/68 Mar 31/69	Apr 1/69 Mar 31/70	Apr 1/70 Mar 31/71
Government							
Finance Co.							
Industrial							
Investment Co.							
Mining							
Mutual Fund							
Total							

(c) How many private placements have you assisted in in each of the past 7 years?

Type of Issuer	For fiscal year ended between						
	Apr 1/64 Mar 31/65	Apr 1/65 Mar 31/66	Apr 1/66 Mar 31/67	Apr 1/67 Mar 31/68	Apr 1/68 Mar 31/69	Apr 1/69 Mar 31/70	Apr 1/70 Mar 31/71
Government							
Finance Co.							
Industrial							
Investment Co.							
Mining							
Mutual Fund							
Total							

(d) What was the total dollar value (in thousand dollars) of private placements placed by you in each of the past 7 years?

Type of Issuer	For fiscal year ended between						
	Apr 1/64 Mar 31/65	Apr 1/65 Mar 31/66	Apr 1/66 Mar 31/67	Apr 1/67 Mar 31/68	Apr 1/68 Mar 31/69	Apr 1/69 Mar 31/70	Apr 1/70 Mar 31/71
Government							
Finance Co.							
Industrial							
Investment Co.							
Mining							
Mutual Fund							
Total							

VIII. General Opinion

1. Is your firm in favour of securities firms in Canada being able to raise capital from the public in a broader and more flexible manner than that proposed by the Moore Report (pp. 100-104)?

Yes _____ No _____

(a) What are the advantages of this broader proposal?

(b) What are the disadvantages of this broader proposal?

2. Comment on the following as appropriate controls for this broader proposal.

- (a) Stricter requirements for certified financial statements than in an ordinary distribution to the public.
- (b) Firm in business for at least five years prior to distribution with three of the five years profitable.
- (c) Majority of directors in the securities business for five years prior to distribution.
- (d) Firm's ratio of net capital to debt significantly below ordinary requirements for registrants.
- (e) Size of offering no larger than three times firm's net worth and offering price established after recommendations by two qualified independent underwriters represented by independent legal counsel.
- (f) Firm could participate in distribution but transactions could not be executed for discretionary account without customer's prior written approval.
- (g) Other _____

IX. Specify location of principal place of business _____

Date _____

Signature of Proprietor, Partner or
Officer
(139)

For reference we herewith enclose a summary of the Moore Committee proposals as modified by the Joint Industry Committee proposals.

SUMMARY OF MOORE COMMITTEE PROPOSALS AS MODIFIED
BY JOINT INDUSTRY COMMITTEE PROPOSALS

The following is a summary of the recommendations made by the Moore Committee, as modified by the Joint Industry Committee.

I) Extent of Outside Participation in Canadian Securities Firms

Subject to the rules summarized below and to the requirement that each transaction be approved by regulatory authorities, firms may raise money on either a debt or an equity basis from individuals (but not companies) who are approved by the regulatory authorities as approved investors. In addition, they may borrow from chartered banks and other approved lending institutions. The most important restriction is that the industry investors in a firm - i.e., its full-time or retired officers and employees and their spouses, holding companies and registered retirement savings plans - must own at least 60% of the capital. This rule allows firms to increase their capital by 66-2/3% (a firm which has capital of \$3 million could raise \$2 million).

Another general restriction is that the number of approved investors holding equity investments in a firm may not exceed 25. This restriction does not affect the holders of debt securities and does not apply at all to banks and other approved lending institutions.

Special restrictions apply to certain types of securities, as follows:

- 1) no more than 25% of a firm's participating or voting securities may be issued to investors other than industry investors, and no one outside investor may hold more than 10% of a firm's participating or voting securities. Participating or voting securities

may not be issued to chartered banks or other lending institutions, except that special provision is made for the right to issue to them limited participation debt securities, carrying a fixed interest rate and a participation right limited to one-half that rate;

2) if subordinated debt is issued to approved investors, it must be for a term of at least two years and be rolled over three months prior to maturity; these requirements do not apply to subordinated debt issued to chartered banks or other lending institutions;

3) when a firm has subordinated debt outstanding any of which is held by outside investors (i.e. approved investors, banks or other approved lending institutions) it must maintain junior capital - equity or junior subordinated debt - in at least a 3 for 1 ratio with the subordinated debt;

4) if any securities are issued which contain provisions restricting the firm that might confer a substantial influence on the holder of the securities, no approved investor could hold over 10% of the class of securities; this restriction would not apply to banks and other approved lending institutions.

It will be noted that none of the above four rules applies to non-participating equity securities, such as preference shares with a fixed dividend. To allow flexibility, limited participation equity securities, carrying a fixed dividend rate and a participation right limited to half that rate, are treated as non-participating. These may, then, be issued to approved investors subject only to the 40% and the 25-investor limits described above.

Arrangements must also be made in the case of participating securities to ensure that any sales made by investors who are not industry investors are effected at the same price that is available to industry investors under applicable buy-sell arrangements within the particular firm. The arrangements must also provide for the forced sale of all the securities held by an investor who is not an industry investor if his approval is withdrawn by regulatory authorities.

The proposed restrictions do not affect investments by one Canadian securities firm in another Canadian securities firm. These continue to be governed by the policies of the regulatory authorities. The rules would specifically permit a non-resident securities firm to be an approved investor and as such to acquire up to 10% of a Canadian firm - subject to the rules above, including the restriction to a maximum of 25% for outside ownership of participating or voting securities. To assist smaller firms the rules would allow, until March 31, 1986, for a non-resident firm to acquire more than 10% of a Canadian firm, subject to a maximum of \$250,000 or 25%.

II) Restrictions on Non-Resident Firms

No new non-resident firms could enter Canada (except through acquisition of a minority interest in a Canadian firm as described above), either directly or by acquisition of control over a Canadian firm.

Existing non-resident-controlled firms in Canada are entitled to the protection of a "grandfather" clause, provided that any firm with capital of over \$1,000,000 must comply with one of the following sets of rules:

EITHER (1) the maximum capital used in Canada by the non-resident firm would be that required by the capital formulae of the stock exchanges and the I.D.A. to sustain the business transacted during a recent fiscal year ended not later than March 31, 1971 plus 10% of the firm's net earnings in Canada during each year after that year;

OR (2) the same rule as in (1) would apply except that the percentage of subsequent years' earnings which could be retained would be increased from 10% by 1.2% for each 1% of equity acquired by Canadians, provided the equity was sold to Canadians at least as quickly as contemplated by the following timetable:

15% by 1974

30% by 1977

45% by 1980

60% by 1983

75% by 1986

Full compliance with the restrictions applicable to Canadian firms would be required by 1989.

The alternative described above would not be available to a non-resident firm which raised money in a manner not open to Canadian firms, for example by a public distribution of its shares, or the control of which changed. Such firms must comply with rule (2) above.

APPENDIX "C"

Ontario Registrants
to whom Questionnaire was sent

John C. Allen Ltd.
A.E. Ames & Co.
A.E. Ames & Co. Ltd.
A.G.F. Management Limited
A.G.F. Toronto Investment Management Inc.
Andras, Hatch & Hetherington Ltd.
Annett Partners Ltd.
J. Appleby Securities Limited
Asta Securities Corporation Limited
Babson's Canadian Reports Limited
Bache & Co. Incorporated
Baker, Weeks of Canada Ltd.
Bankers Securities of Canada Limited
Barclay & Crawford Ltd.
Bartlett, Cayley & Company Limited
The Bauman Letter
B B & D Investment Management Limited
Beatty, Webster & Company Limited
A.G. Becker (Canada) Limited
Bell, Gouinlock & Company Limited
Belshaw & Company Limited
Beutel, Goodman & Company
Bongard, Leslie & Co. Limited
Bolton, Tremblay & Company
Bonnycastle, Crerar & Associates Limited
Bouchard & Co. Ltd.

Brawley Cathers Limited
Brown, Baldwin, Nisker Limited
Alfred Bunting & Co. Limited
Burgess Graham Securities Limited
Burns Bros. and Denton Limited
Canadian American Financial Corp.
Canadian Business Service Publications Ltd.
Canadian Security Management Limited
Canavest House Limited
J.P. Cannon & Co. Limited
Cassels, Blaikie & Co. Limited
Charterhouse Securities of Canada Limited
Hector M. Chisholm & Co. Limited
CIAG Investments Limited
Helen W. Cleveland
Cliche & Associates Ltd.
Cochran Murray Limited
Collier, Norris & Quinlan Limited
Confederation Securities Limited
Corporate Investors (Marketing) Limited
J.H. Crang & Co. Limited
The Cumco Corporation Limited
R.A. Daly & Company Limited
Davidson & Company
F.H. Deacon & Company Limited
Deane Elliott Investments, Inc.
Dean Witter International Incorporated
Distinct Portfolios Limited
Diversified Investment Services Limited
Doherty Roadhouse & McCuaig
Dominick Corporation of Canada Limited

Dominion Securities Company
Dominion Securities Corporation Limited
Draper Dobie & Company Limited
Drexel Firestone (Canada) Limited
Dreyfus Sales of Canada Limited
duPont, Glore Forgan Canada Limited
Durham Securities Corporation Limited
Easton, Fisher & Company Limited
Eaton Fund Distributors Limited
E-L Investment Management Limited
Elliott & Page Limited
Equitable Securities Limited
G. Tower Fergusson Limited
Fiscal Consultants of Canada Limited
Fraser, Dingman & Co.
Leon Frazer & Associates Limited
Fry Investment Management Limited
Fry Mills Spence Limited
Fry Mills Spence Securities Limited
Fry Securities Limited
Gairdner & Company Limited
Gardiner, Watson Limited
Gardiner, Watson, Edmonds Limited
G.I.S. Associates Limited
Glandfield & Co. Limited
Goodwin Harris & Company Limited
Good, Samuel Benjamin, operating under the
name of The Goodwin Letter
Gordon Daly Grenadier Limited
Gordon Securities Limited
Goulding, Rose & Turner Limited

John Graham & Company Limited
Grant Johnston Limited
M. Greene & Associates Limited
Greenshields Incorporated
Greenshields Ltd.
Guardian Growth Financial Services Limited
Harris & Partners Investment Advisory
Service Limited
Harris & Partners Limited
Harris & Partners Securities Limited
E. Paul Henry Management Limited
Herbert & Co. Securities Ltd.
Hevenor & Co. Limited
Hill Vincent Associates
C.J. Hodgson & Co. Inc.
C.J. Hodgson & Co. Ltd.
Holland, Andrews, Perrier & Co. Ltd.
Housser & Company Limited
I.M.H. Management (Hamilton) Limited
Independent Investors Counselling Limited
Indicator Research Company Limited
Industrial Growth Management Limited
International Fund Distributors Limited
Investment Research & Management Limited
Investors Syndicate Limited
Isard, Robertson, Easson Co. Ltd.
Jenkin Evans & Co. Ltd.
J. & H.W.F. Equity Corporation Limited
K.M. Johnston Investment Counsel
Jones, Gable & Company Limited
Jones Heward & Company Ltd.
J R F Financial Consultants Ltd.

Kamm, Garland & Co. Limited
C.A. Kee & Company
Kernaghan & Co. Limited
Kilgorie Distributors Limited
Charles King & Co.
King, Curtin & Saunders Limited
Kippen & Company Inc.
Laidlaw & Co. Incorporated
Lamont and Company Limited
Lancet Management Limited
W.D. Latimer Co. Limited
Frank S. Leslie & Co. Limited
Levesque, Beaubien Inc.
Wayne H. Levine & Company
Liberty Securities Limited
Lifetime Financial Services Ltd.
Lindsay, McKelvey & Company Limited
Locana Securities Ltd.
Loewen, Ondaatje, McCutcheon & Company Limited
Loomis, Sayles & Company (Canada) Ltd.
John H. Luxton
MacDougall, MacDougall & MacTier Ltd.
MacHold Investments Ltd.
MacKenzie Fund Sales Inc.
A.C. MacPherson & Co. Ltd.
Maison Placements Canada Inc.
Magthor Management Limited
E.A. Manning Limited
Marchment & MacKay Limited
Martin, Lucas & Company Limited
Matthews & Company Limited

May, Mikkila and Co. Limited
McConnell & Company Limited
McConnell Craig Capital Advisor Limited
McDonnell, Adams & Co. Limited
McEwen Securities Limited
George J. McKie & Son
McLeod, Young, Weir & Company Limited
McLeod, Young, Weir & Ratcliffe
Mead & Co. Limited
Meighen Wood Limited
Merrill Lynch, Pierce, Fenner & Smith,
Incorporated
Merrill Lynch, Pierce, Fenner & Smith of
Canada Limited
Midland-Osler Securities Limited
Morgan, Ostiguy & Hudon Inc.
Moss, Lawson & Co. Limited
Nesbitt, Thomson and Company Limited
Nesbitt, Thomson Securities Limited
Netherlands Overseas Corporation Canada
Limited
Northridge Investments Limited
Norwich Investments Limited
N W Investments Ltd.
O'Brien & Williams
A.E. Osler Company Limited
Oswald, Drinkwater & Graham Ltd.
Pemberton Securities Limited
Pitfield, MacKay, Ross & Company Limited
Planned Investments Corporation
Pope & Company
Portfolio Management Limited

Prudential Fund Management Canada Limited
M. Rash & Co. Limited
Regal Mutual Fund Distributors Limited
Research Securities of Canada Ltd.
Richardson Securities of Canada
T.A. Richardson & Co. Limited
Rosmar Corporation Limited
Ross-Minns Investments Limited
Royal Securities Corporation Limited
St. Lawrence Securities Limited
N.L. Sandler & Co. Limited
E.M. Saunders Limited
Savings and Investment Ltd.
Scholarship Consultants of North America Ltd.
Eric Schwendau & Associates
Scudder, Stevens & Clark of Canada Limited
Selected Fund Distributors
Norman Short and Associates Limited
S.M.C. Distributors Ltd.
H.E. Smith Securities Limited
Henry S. Spicer Limited
Standard Securities Limited
Sterling-Atkins Limited
J. Bradley Streit & Company Limited
Swiss Corporation for Canadian Investments
Taranco Company Limited
Tezac Investments Limited
Donald A. Thomson Co. Limited
F.W. Thompson Co. Limited
Thomson, Kernaghan & Co. Ltd.
J.R. Timmins & Co.

Tom & Barnt Limited
Triarch Securities Corporation Limited
United Investment Services Limited
Walter George Upshall
Walwyn Stodgell & Co. Limited
Waterloo Bond Corporation Limited
Donald R. Watt Securities Limited
J.B. White & Company Limited
Wills, Bickle & Company Limited
Wisener and Partners Company Limited
Wisener, MacKellar and Company Limited
Wood, Gundy (International) Limited
Wood, Gundy Limited
Yorkton Securities Limited

APPENDIX "D"

NON-RESIDENT OWNED FIRMS REGISTERED WITH THE OSC

Bache & Co. Inc.	TSE - IDA
Baker, Weeks of Canada	TSE - IDA
A.G. Becker (Canada) Ltd.	Sec. Dlr.
Canadian American Financial Corp.	Scholarship Dlr.
Charterhouse Securities of Canada Ltd.	Sec. Dlr.
Dean, Witter International Inc.	Sec. Dlr.
Dominick Corporation of Canada Ltd.	TSE - IDA
Drexel Firestone (Canada) Ltd.	Sec. Dlr.
duPont, Glore Forgan Canada Ltd.	TSE - IDA
Harris & Partners Ltd.	IDA
Harris & Partners Securities Ltd.	TSE - IDA
Chas. King & Co.	TSE, IDA, Sec. Dlr.
Laidlaw & Co. Inc.	TSE
Merrill Lynch, Pierce, Fenner & Smith, Inc.	IDA
Merrill Lynch, Pierce, Fenner & Smith of Canada Ltd.	TSE - IDA
Netherlands Overseas Corporation Canada Limited	Sec. Dlr.
Royal Securities Corporation Ltd.	IDA
J.R. Timmins & Co.	TSE - IDA
Swiss Corporation for Canadian Investments Ltd.	Sec. Dlr.
Triarch Securities Corporation Ltd.	Sec. Dlr.
Babson's Canadian Reports Ltd.	Invest. Counsel
Bolton, Tremblay & Co.	Invest. Counsel
Harris & Partners Investment Advisory Service Ltd.	Invest. Counsel

Loomis, Sayles & Company (Canada) Ltd.	Invest. Counsel
Elliott & Page Ltd.	Invest. Counsel
Scudder, Stevens & Clark of Canada Ltd.	Invest. Counsel
Corporate Investors (Marketing) Ltd.	Mut. Fund Dlr.
Diversified Investment Services Ltd.	Mut. Fund Dlr.
Dreyfus Sales of Canada Ltd.	Mut. Fund Dlr.
J & H.W.F. Equity Corporation Ltd.	Mut. Fund Dlr.
Lifetime Financial Services Ltd.	Mut. Fund Dlr.
Planned Investments Corporation	Mut. Fund Dlr.
Prudential Fund Management Canada Ltd.	Mut. Fund Dlr.
United Investment Services Ltd.	Mut. Fund Dlr.
Ballinsloe Investments Ltd.	Underwriter
The Dreyfus Sales Corporation	Underwriter
The First Boston Corporation	Underwriter (restricted to Kaiser Resources Ltd.)
Initiative Explorations Ltd.	Underwriter

as at December 31, 1971

APPENDIX "E"

ONTARIO REGISTERED MONEY MARKET DEALERS

Greenshields Incorporated
Wood Gundy Limited
Fry Mills Spence Limited
Gairdner & Company Limited
Dominion Securities Corporation Limited
McLeod, Young, Weir & Company Limited
Nesbitt, Thomson and Company Limited
Equitable Securities Limited
Cochran Murray Limited
Richardson Securities of Canada
A.E. Ames & Co. Limited
Burns Bros. and Denton Limited
Midland-Osler Securities Limited
Royal Securities Corporation Ltd.
Harris & Partners Limited

as at December 31, 1971

APPENDIX "F"

TABLES RELATING TO THE FINANCIAL PROFILE

Table 10. Investment Dealers
71 Canadian owned firms

Balance Sheet

Fiscal year ended on or
before March 31, 1971
thousands of dollars

Total Assets 1,671,057

Liabilities

Call Loans	872,055
Other Liabilities	<u>659,580</u>
Total	<u>1,531,635</u>

Capital and Surplus

Share Capital	48,549
Surplus or Undistributed Profit	66,550
Reserves	699
Subordinated Loans	22,167
Other	<u>1,456</u>
Total	<u>139,421</u>

Total Liabilities and Capital 1,671,057

Table 11. Assets of Largest Resident owned
Investment Dealers

	Fiscal year ended between April 1/70 and March 31/71 thousands of dollars	% of Total
Assets of 5 largest firms	971,404	58.1
Assets of 10 largest firms	1,348,049	80.5
Assets of 12 largest firms including 2 non-resident owned companies	1,634,951	83.6

Table 12. Investment Dealers
71 Canadian owned firms

	<u>Capitalization</u>	
Fiscal year ended on or before	Share Capital	Subordinated Loans
	thousands of dollars	
April 1, 1964	32,660	5,816
March 31, 1965	32,961	8,912
March 31, 1966	35,413	8,147
March 31, 1967	41,514	8,399
March 31, 1968	41,205	11,004
March 31, 1969	42,571	15,310
March 31, 1970	44,219	20,753
March 31, 1971	48,549	22,167

Table 13. Investment Dealers
71 Canadian owned firms

	Income and Expenses						Change 65-71
	for the fiscal year ended on or before March 31,						
	<u>1965</u>	<u>1966</u>	<u>1967</u>	<u>1968</u>	<u>1969</u>	<u>1970</u>	<u>1971</u>
	thousands of dollars						
<u>Income</u>							
Total Income	119,894	126,667	124,637	162,911	269,377	274,969	213,518 + 79%
<u>Expenses</u>							
Total Remuneration to Employees	38,784	44,384	46,106	55,527	84,293	93,950	75,308 +106%
Research Expenditures	1,540	1,999	2,211	2,699	4,549	5,073	5,356 +247%
Commission to other Brokers	1,713	1,819	1,992	3,427	5,451	4,375	3,523 +106%
Communications	8,115	9,341	10,474	12,506	15,989	19,826	18,977 +133%
Occupancy & Equipment	6,245	7,182	8,007	9,483	12,112	14,610	17,195 +174%
Promotional	3,694	4,040	4,546	4,669	6,040	7,232	6,966 + 89%
Other	20,288	22,601	24,677	32,926	51,000	54,400	46,340 +132%
Total Expenses	80,379	91,366	98,013	121,237	179,434	199,466	173,665 +116%
Income before shareholders/Partners remuneration	39,515	35,301	26,624	41,674	89,943	75,503	39,853 + 8%
Total Shareholders/ Partners remuneration	23,319	23,575	21,724	26,177	48,613	47,626	35,827 + 54%
Net Income or (Loss) after Income Tax	9,571	7,095	2,142	9,376	24,257	13,422	(212)

Table 15. Investment Dealers
71 Canadian Owned firms

Income and Expenses

For the fiscal year ended
on or before March 31, 1971
thousands of dollars

Total Gross Income	\$213,518
Total Expenses	173,665
Shareholders Remuneration	35,827
Net Income or (Loss) after Income Tax	(212)

Table 16. Underwriting
All Canadian owned registrants

Total Underwriting of All Types (including Government)

	<u>Total Under- writing</u>	<u>Five Largest Firms</u>	<u>% of Total</u>	<u>Ten Largest Firms</u>	<u>% of Total</u>
			thousands of	dollars	
64-65	1,911,113	788,514	43.4	1,127,389	59.0
65-66	1,939,621	842,541	43.4	1,234,701	63.7
66-67	2,052,206	826,691	40.3	1,220,749	59.5
67-68	2,280,905	877,428	38.5	1,363,481	59.8
68-69	2,004,203	805,167	40.2	1,209,761	60.4
69-70	2,048,996	828,293	40.4	1,197,408	58.4
70-71	2,970,263	1,188,526	40.0	1,859,531	62.6
	<u>Industrial Under- writing</u>	<u>Five Largest Firms</u>	<u>% of Total</u>	<u>Ten Largest Firms</u>	<u>% of Total</u>
			thousands of	dollars	
64-65	378,143	160,807	42.5	221,582	58.6
65-66	483,163	208,812	43.2	346,118	71.6
66-67	471,329	230,528	48.9	303,029	64.3
67-68	601,254	250,406	41.6	383,933	63.9
68-69	521,382	249,303	47.8	333,449	64.0
69-70	755,807	383,100	50.7	547,577	72.4
70-71	1,123,093	493,556	44.0	732,026	65.2

Table 17. Brokers
Form of Ownership

<u>Form</u>	<u>Canadian</u>	<u>Foreign</u>
Corporation	4	1
Partnership	-	-
Proprietorship	1	-
Corporation and Partnership	-	-
	<hr/>	<hr/>
Total	5	1

Table 18. Brokers
5 Canadian owned firms

Balance Sheet

Fiscal year ended on or
before March 31, 1971
thousands of dollars

Total Assets 10,693

Liabilities

Call Loans	2,330
Other Liabilities	<u>5,874</u>
Total	<u>8,204</u>

Capital and Surplus

Share Capital	634
Surplus or Undistributed Profit	923
Reserves	-
Subordinated Loans	932
Other	-
Total	<u>2,489</u>

Total Liabilities and Capital 10,693

Table 19. Brokers
5 Canadian owned firms

Capitalization

<u>Fiscal year ended on or before</u>	<u>Share Capital</u> thousands of dollars	<u>Subordinated Loans</u> thousands of dollars
April 1, 1964	757	617
March 31, 1965	757	617
March 31, 1966	757	567
March 31, 1967	757	617
March 31, 1968	772	827
March 31, 1969	642	1,027
March 31, 1970	633	1,187
March 31, 1971	634	932

Table 20. Brokers
5 Canadian owned firms

Income and Expense							
	for the fiscal year ended on or before March 31,						Change
	1965	1966	1967	1968	1969	1970	65-71
Income	thousands of dollars						
Total Income	2,004	2,122	1,956	2,755	4,678	4,812	3,609 + 80%
Expenses							
Total Remuneration to Employees	769	805	841	921	1,512	1,580	1,265 + 65%
Research Expenditures	7	9	9	15	22	26	25 +257%
Commission to other Brokers	26	37	33	34	152	125	95 +266%
Communications	106	127	145	157	206	252	252 +138%
Occupancy & Equipment	113	103	130	134	152	185	209 + 85%
Promotional	34	38	40	44	65	84	74 +118%
Other	407	418	454	607	1,172	1,129	1,056 +159%
Total Expenses	1,464	1,537	1,652	1,912	3,281	3,381	2,976 +103%
Income before Shareholders/Partners							
Remuneration	540	585	304	843	1,397	1,431	633 + 17%
Total Shareholders/Partners							
Remuneration	359	389	284	584	917	1,168	613 + 71%
Net Income or (Loss) after Income Tax	118	137	13	153	298	172	(6)

Table 21. Brokers
5 Canadian owned firms

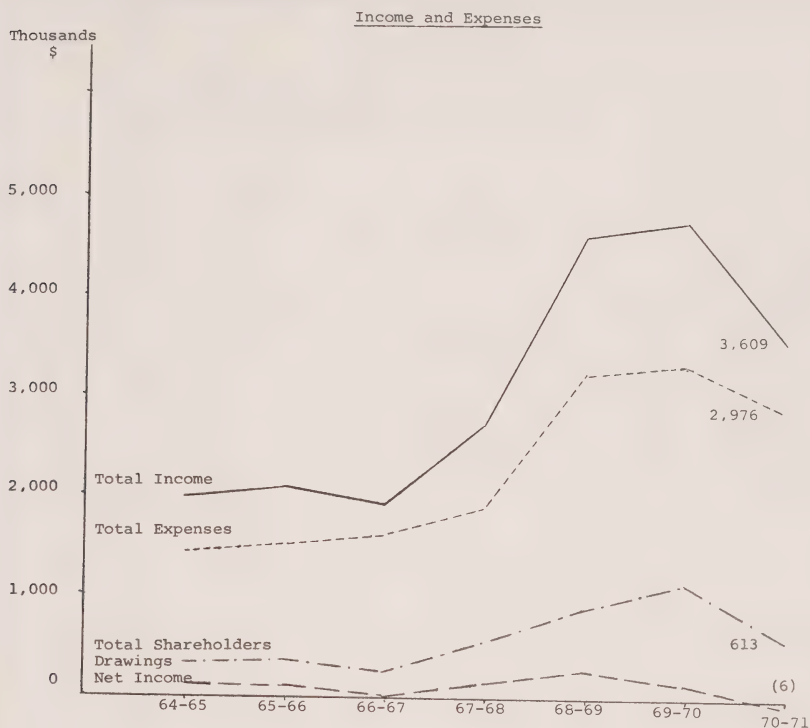


Table 22. Broker-dealers
Form of Ownership

<u>Form</u>	<u>Canadian</u>	<u>Foreign</u>
Corporation	27	-
Partnership	-	-
Proprietorship	-	-
Corporation and Partnership	-	-
	27	-

Table 23. Broker Dealers
27 Canadian owned firms

Balance Sheet

Fiscal year ended on or
before March 31, 1971
thousands of dollars

Total Assets 40,961

Liabilities

Call Loans	13,711
Other Liabilities	<u>16,396</u>
Total	<u>30,107</u>

Capital and Surplus

Share Capital	3,054
Surplus or Undistributed Profit	6,054
Reserves	346
Subordinated Loans	1,340
Other	61
Total	<u>10,854</u>

Total Capital and Liabilities 40,961

Table 24. Broker Dealers
27 Canadian owned firms

Capitalization

<u>Fiscal year ended</u> <u>on or before</u>	<u>Share</u> <u>Capital</u> thousands	<u>Subordinated</u> <u>Loans</u> of dollars
April 1, 1964	3,480	411
March 31, 1965	1,796	1,737
March 31, 1966	1,881	1,657
March 31, 1967	1,944	1,412
March 31, 1968	2,742	1,638
March 31, 1969	2,757	2,323
March 31, 1970	3,040	1,802
March 31, 1971	3,054	1,340

Table 25. Broker Dealers
27 Canadian owned firms

Income and Expenses								
	for the fiscal year ended on or before March 31,					Change		
	<u>1965</u>	<u>1966</u>	<u>1967</u>	<u>1968</u>	<u>1969</u>	<u>1970</u>	<u>1971</u>	<u>65-71</u>
Income	thousands of dollars							
Total Income	9,098	10,882	10,109	10,541	18,693	16,881	12,363	+ 36%
Expenses								
Total Remuneration to Employees	2,805	3,923	4,111	3,836	5,516	5,378	4,583	+ 63%
Research Expenditures	27	34	39	37	43	271	386	+1537%
Commission to other Brokers	43	36	111	149	225	190	198	+ 360%
Communications	547	1,095	1,300	1,106	1,139	1,175	1,223	+ 124%
Occupancy & Equipment	291	367	453	514	616	794	959	+ 230%
Promotional	213	287	341	307	419	457	383	+ 22%
Other	2,044	2,265	1,823	2,030	3,590	2,908	2,688	+ 32%
Total Expenses	5,970	8,008	8,178	7,979	11,548	11,173	10,420	+ 75%
Income before Share-holders/Partners								
Remuneration	3,128	2,874	1,931	2,561	7,145	5,708	1,943	- 38%
Total Share-holders/Partners								
Remuneration	1,158	1,364	1,326	1,861	3,641	3,321	2,399	+ 107%
Net Income or (Loss) after Income Tax	1,034	854	333	301	1,652	1,079	(753)	

Table 26. Broker-dealers
27 Canadian owned firms

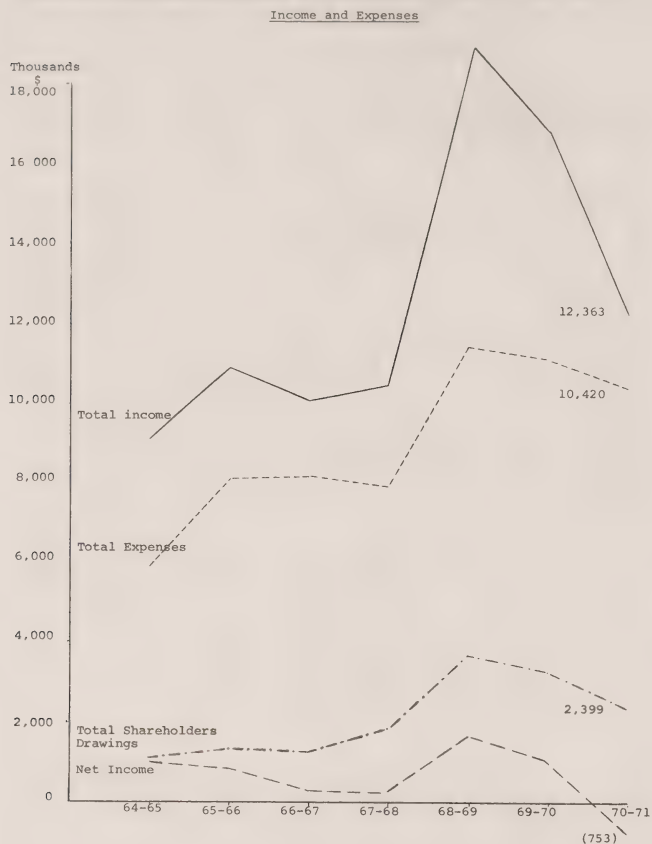


Table 27. Securities Dealers
Form of Ownership

Form	Canadian	Foreign
Corporation	5	6
Partnership	-	-
Proprietorship	-	-
Corporation and Partnership	-	-
Total	5	6

Table 28. Securities Dealers
5 Canadian owned firms

Balance Sheet

Fiscal year ended on or
before March 31, 1971
thousands of dollars

Total Assets 6,520

Liabilities

Call Loans	652
Other Liabilities	<u>3,850</u>
Total	<u>4,502</u>

Capital and Surplus

Share Capital	983
Surplus or Undistributed Profit	953
Reserves	2
Subordinated Loans	80
Other	-
Total	<u>2,018</u>

Total Liabilities and Capital 6,520

Table 29. Securities Dealers
5 Canadian owned firms

Capitalization

<u>Fiscal year ended on or before</u>	<u>Share Capital</u> thousands	<u>Subordinated Loans</u> of dollars
April 1, 1964	553	-
March 31, 1965	553	-
March 31, 1966	553	-
March 31, 1967	553	-
March 31, 1968	553	-
March 31, 1969	553	60
March 31, 1970	953	80
March 31, 1971	983	80

Table 30. SECURITIES DEALERS

5 Canadian owned firms

	Income and Expenses							Change
	for fiscal year ended on or before March 31,							65-71
	1965	1966	1967	1968	1969	1970	1971	
Income	thousands of dollars							
Total Income	946	819	703	963	1,943	1,421	2,375	+151%
Expenses								
Total Remuneration to Employees	160	179	185	228	375	360	426	+166%
Research Expenditures	1	1	-	1	-	6	52	
Commissions to other Brokers	39	24	12	33	54	37	64	+ 64%
Communications	43	45	49	53	80	92	124	+188%
Occupancy & Equipment	55	59	50	56	63	65	140	+155%
Promotional	10	12	13	18	27	28	20	+100%
Other	203	197	178	244	421	339	473	+133%
Total Expenses	511	517	487	633	1,020	928	1,299	+154%
Income before Share-holders/Partners								
Remuneration	435	302	216	330	923	493	1,076	+147%
Total Share-holders/Partners								
Remuneration	301	245	120	248	650	386	488	+ 62%
Net Income after Income Tax	74	38	72	62	154	57	325	+295%

Table 31. Securities Dealers
\$ Canadian owned firms

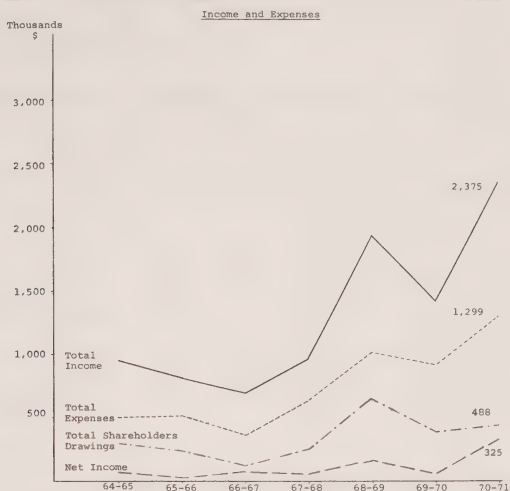


Table 32. Investment Dealers, Brokers, Broker-dealers, & Securities Dealers

Functions Performed

	<u>Investment Dealers</u>		<u>Brokers</u>		<u>Broker-dealers</u>		<u>Securities Dealers</u>	
	<u>yes</u>	<u>no</u>	<u>yes</u>	<u>no</u>	<u>yes</u>	<u>no</u>	<u>yes</u>	<u>no</u>
Advisory								
Domestic	30	34	1	4	3	24	1	6
Foreign	4	6	1	0	0	0	2	4
Brokerage								
Domestic	63	1	5	0	16	11	5	2
Foreign	8	2	1	0	0	0	4	2
Margin Facility								
Domestic	43	21	5	0	9	18	2	5
Foreign	6	4	0	1	0	0	3	3
Dealer								
Domestic	51	13	1	4	13	14	0	7
Foreign	7	3	1	0	0	0	4	2
Merchant Banker								
Domestic	5	61	0	5	1	26	0	7
Foreign	0	10	0	1	0	0	2	4
Money Market								
Domestic	16	48	0	5	0	27	0	7
Foreign	3	7	1	0	0	0	1	5
Underwriting								
Domestic	45	19	1	4	18	9	1	6
Foreign	6	4	1	0	0	0	2	4

Table 33. Investment Dealers, Brokers, Broker-dealers,
& Securities Dealers

Business Refused in Functions Performed

	Investment Dealers			Brokers			Broker- dealers			Securities Dealers		
	yes		no	yes		no	yes		no	yes		no
	ans.	ans.	ans.	ans.	ans.	ans.	ans.	ans.	ans.	ans.	ans.	ans.
Advisory												
Domestic	0	46	18	0	2	3	0	8	19	0	0	7
Foreign	0	6	4	0	0	1	0	0	0	0	2	3
Brokerage												
Domestic	1	62	1	0	3	2	0	12	15	0	2	5
Foreign	0	9	1	0	0	1	0	0	0	0	4	2
Margin Facility												
Domestic	3	46	15	0	3	2	0	4	23	0	1	6
Foreign	0	6	4	0	0	1	0	0	0	0	2	4
Dealer												
Domestic	2	59	3	0	2	3	0	12	15	0	0	7
Foreign	1	7	2	0	0	1	0	0	0	0	3	3
Merchant Banker												
Domestic	3	37	24	2	0	3	0	7	20	0	0	7
Foreign	0	5	5	0	0	1	0	0	0	0	2	3
Money Market												
Domestic	2	43	19	2	0	3	0	7	20	0	0	7
Foreign	1	6	3	0	0	1	0	0	0	0	2	4
Underwriting												
Domestic	2	57	5	2	0	3	3	11	13	0	0	7
Foreign	0	7	3	0	0	1	0	0	0	0	2	4

Table 34. Investment Dealers

Anticipated Changes in Functions Performed

	<u>2 years</u>			<u>10 years</u>		
	<u>Grow</u>	<u>Decrease</u>	<u>No Change</u>	<u>Grow</u>	<u>Decrease</u>	<u>No Change</u>
Advisory	28	0	20	36	0	13
Brokerage	48	2	14	51	3	9
Margin Facility	28	5	18	31	6	15
Dealer	37	0	19	40	1	14
Merchant Banker	9	0	18	9	0	17
Money Market	20	1	16	23	0	14
Underwriting	40	1	11	49	1	4

Table 35. Brokers

Anticipated Changes in Functions Performed

	<u>2 years</u>			<u>10 years</u>		
	<u>Grow</u>	<u>Decrease</u>	<u>No Change</u>	<u>Grow</u>	<u>Decrease</u>	<u>No Change</u>
Advisory	3	-	-	3	-	-
Brokerage	4	-	-	4	-	-
Margin Facility	3	-	-	3	-	-
Dealer	1	-	-	1	-	-
Merchant Banker	-	-	-	-	-	-
Money Market	-	-	-	-	-	-
Underwriting	-	-	-	1	-	-

Table 36. Broker-dealers

	2 years			10 years		
	Grow	Decrease	No	Grow	Decrease	No
			Change			Change
Advisory	2	-	1	2	-	-
Brokerage	10	1	5	12	-	-
Margin Facility	3	-	3	3	-	4
Dealer	5	3	3	7	2	2
Merchant Banker	1	-	-	1	-	-
Money Market	1	-	-	1	-	-
Underwriting	15	3	3	16	2	2

Table 37. Securities Dealers

	2 years			10 years		
	Grow	Decrease	No	Grow	Decrease	No
			Change			Change
Advisory	-	-	-	1	-	-
Brokerage	3	-	1	4	-	1
Margin Facility	1	-	-	1	-	-
Dealer	-	-	-	-	-	-
Merchant Banker	-	-	-	-	-	-
Money Market	-	-	-	-	-	-
Underwriting	-	-	-	-	-	1

Table 38. All Registrants

Response to the Moore Report Proposals

	<u>Domestic</u>			<u>Foreign</u>		
	<u>yes</u>	<u>no</u>	<u>answer</u>	<u>yes</u>	<u>no</u>	<u>answer</u>
Investment dealers	23	4	37	4	2	4
Brokers	2	0	3	0	0	1
Broker-dealers	6	9	12	0	0	0
Securities dealers	3	1	3	1	0	5
Mutual Fund dealers	-	-	not applicable	-	-	-
Investment Counsel	-	-	not applicable	-	-	-
Securities Advisers	-	-	not applicable	-	-	-

Table 39. All Registrants

Response to the Underwriting Question

	<u>Domestic</u>			<u>Foreign</u>		
	<u>yes</u>	<u>no</u>	<u>answer</u>	<u>yes</u>	<u>no</u>	<u>answer</u>
Investment dealers	60	7	5	6	1	3
Brokers	1	4	2	1	0	0
Broker dealers	22	4	1	0	0	0
Securities dealers	2	2	3	3	0	3
Mutual Fund dealers	1	1	18	1	1	5
Investment Counsel	-	-	not applicable	-	-	-
Securities Advisers	-	-	not applicable	-	-	-

Table 40. All Registrants

Response to an Alternate
to the Moore Report Proposals

	Domestic			Foreign		
	<u>yes</u>	<u>no</u>	<u>answer</u>	<u>yes</u>	<u>no</u>	<u>answer</u>
Investment dealers	29	40	3	3	3	4
Brokers	0	3	2	1	0	0
Broker dealers	3	21	3	0	0	0
Securities dealers	3	3	1	2	0	4
Mutual Fund dealers	6	1	13	1	0	6
Investment Counsel	4	6	9	0	2	4
Securities Advisers	0	2	0	0	0	0

APPENDIX "G"

People Appearing at the Hearings
of the Industry Ownership Study

The Toronto Stock
Exchange

Mr. J.R. Kimber, President
Mr. D.G. Lawson, Chairman of
the Board of Governors
Mr. B.G. Willis, Governor
Mr. R.T. Morgan, Governor and
Chairman, Toronto Stock
Exchange Committee on
Industry Ownership
Mr. W.L. Somerville, Vice-
President
Mr. P. Bunting, Governor
Mr. A.J. MacIntosh, Counsel

Mr. Alan Heisey

Investment Dealers'
Association of Canada

Mr. J.B. Cronyn, Vice-President
Mr. H.L. Gassard, Managing
Director
Mr. J.R. LeMesurier
Mr. J.C. Stodgell
Mr. B.W. Douglas
Mr. J.C. Baillie, Counsel

Mr. Percy Bishop

Mr. E.A. Goodman and
Mr. L.R. Wilson

Mr. Trevor Moore

Chairman, Committee to Study the
Requirements and Sources for
Capital and the Implications of
Non-Resident Capital for the
Canadian Securities Industry.

McLeod, Young, Weir and
Company Limited

Mr. George C. MacDonald,
President

Merrill Lynch, Royal
Securities

Mr. Donald I. Webb, Chairman of
the Board, Merrill Lynch,
Royal Securities
Mr. William R. Lilliot, Jr.,
President, Merrill Lynch,
Royal Securities
Mr. E.J. Harrison
Mr. R.B. Ball, President,
Merrill Lynch, Pierce, Fenner
and Smith Incorporated
Mr. George L. Shinn, Vice-
Chairman of the Board, Merrill
Lynch, Pierce, Fenner and
Smith, Inc.
Mr. Robert Davies, Counsel
Mr. Tom Allen, Counsel

Bache and Company
Incorporated

Mr. Stanley F. Klimczak,
Executive Vice-President and
Director
Mr. Frank Kellehen, Resident
Manager of Toronto Operations
and Vice-President
Mr. Peter J. Dey, Counsel

APPENDIX "H"

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APPENDIX "I"

NEW YORK STOCK EXCHANGE RULES AS TO PUBLIC OWNERSHIP

(As summarized in the Submission of the Ontario District of the Investment Dealers Association of Canada)

The following is a summary of the rules with which member firms of the N. Y. S. E. must comply if they wish to distribute or arrange for the distribution of their freely transferable securities to the public. Amendments to the Constitution and Rules of the N. Y. S. E. to reflect these rules came into effect on March 26, 1970.

1. Member corporations, except those whose primary activity is that of a registered trader or a floor broker, may issue freely transferable
 - (a) voting common stock;
 - (b) voting and non-voting participating and/or non-participating preferred stock;
 - (c) debt securities (including both subordinated debt qualifying as net capital under the N. Y. S. E. rules and other debt securities which would not so qualify).
2. Without prior approval of the Board of Governors, no member corporation may have outstanding or issue any freely transferable non-voting common stock except as permitted in the Constitution and Rules.
3. Directors who are active in the business of the member corporation and principal executive officers of the member corporation are required to be members or allied members and beneficial owners of voting common stock of the member corporation.
4. Any stockholder beneficially owning 5% or more of the voting stock of a member corporation who is employed by the member corporation is required to be an allied member and, if he is not employed by the member corporation, is required to be an "approved person" approved by the Board of Governors.
5. Directors employed by the member corporation must comprise a majority of the Board of the corporation.
6. Directors not employed by the member corporation are not required to be allied members, but are required to be beneficial owners of voting stock and "approved persons".
7. All directors shall be prohibited from owning beneficially the stock of any other member corporation, except as approved by the Exchange.

8. All directors must be elected at each annual meeting, but with no limitation on the number of terms a director may serve.
9. "Principal executive officers" are defined to include persons designated by the directors as having senior principal executive responsibility for the member organization's business including the following areas: operations, compliance with rules and regulations of regulatory bodies, finances and credit, sales, underwriting, research and administration. A single individual may have more than one, or all of such responsibilities.
10. Any person who prior to March 26, 1970, was an allied member but, following that date, no longer meets the definition of an allied member, ceases to be an allied member but may continue to perform those functions for his member corporation he was performing prior to March 26, 1970.
11. Members, allied members or directors are prohibited from owning stock of any other member corporation except as a result of a merger, acquisition or other take-over or unless otherwise specifically approved by the Exchange. Member corporations are prohibited from owning stock of another member corporation, except as a result of a merger, acquisition or take-over or in connection with an underwriting or market making function with respect to such stock.
12. A member corporation, after the completion of the distribution of its freely transferable securities, is prohibited from effecting any transaction (except on an unsolicited basis) for the account of any customer in, or making any recommendation with respect to, any such security issued by it.
13. The primary purpose of each member corporation and any parent of such corporation must be the transaction of business as a broker or dealer in securities.
14. Whenever a party required to be approved by the Exchange as a member, allied member or approved person fails or ceases to be so approved, each member corporation having 5% or more of its outstanding voting stock owned by such party shall redeem or convert to a fixed income security such voting securities as may be necessary to reduce the holdings of such party below 5%.
15. The chief executive officer of each member corporation shall submit to the Exchange at such times as the Exchange may require an affidavit listing to the best of his knowledge and belief the name of each non-member beneficially owning 5% or more of its outstanding voting stock.
16. Every member corporation which has outstanding any freely transferable security must have not less than 50% of its net worth attributable to capital stock and at least 25% of its net worth attributable to voting stock.

17. The use of the proceeds of any offering by a member corporation of freely transferable securities is limited to the raising of capital and no more than 20% of a corporation's stockholders' equity (as it exists prior to the first sale of a freely transferable security) may be sold each year for two years by members, allied members, employees or employee pension, retirement or similar plans, either individually or as a group, except by permission of the Board of Governors in the event of death, forced withdrawal, retirement or hardship cases.

APPENDIX "J"

RULES RELATING TO
DEALERS' PUBLIC DISTRIBUTION OF THEIR SECURITIES

1. The issuer must be a public company, and must have prior to the issue a minimum of \$2 million capital, defined in this appendix to mean issued, outstanding and fully-paid shares, contributed or earned surpluses, and reserves, if any, and of this amount not less than \$1 million must be issued, outstanding and fully-paid shares, and of such shares not less than \$500,000 must be voting shares.
2. The following criteria relating to experience and financial stability must be met:
 - (i) the issuer (or its predecessors if the issuer is a newly formed or reorganized corporation) has been actively engaged as a registrant in the securities business for at least five years immediately preceding the filing of the prospectus or statement of material facts and has had a profit from its operations before the shareholder's or partner's remuneration and taxes in at least three of these five years; and
 - (ii) the majority of the Board of Directors has been actively engaged in the securities business for the five years immediately preceding the filing of the preliminary prospectus or statement of material facts.

3. The total dollar amount of the offering (exclusive of those securities attributable to selling securities holders) shall be no larger than two times the capital of the issuer as reflected in the most recent balance sheet as of a date not more than 90 days prior to the filing of the preliminary prospectus. For the purpose of this paragraph the term "selling securities holder" means a person, other than the issuer or an underwriter participating in the offering by the issuer of its securities, holding securities of the issuer prior to such offering.
4. The issuer may issue freely transferable common or special or preferred shares, or debt securities.
5. A majority of the issuer's Board of Directors must be officers of the issuer.
6. Directors not employed by the issuer are required to be beneficial owners of voting shares and "approved persons", here meaning persons approved by the Director.
7. Issuers and their directors are prohibited from owning the securities of any other registrant, other than affiliates, except as an underwriter.
8. The primary purpose of each issuer must be the transaction of business as a dealer in securities.
9. An issuer shall, prior to a public distribution, establish to the satisfaction of the Director that it has made arrangements to ensure that whenever a party

required to be approved by the Director as an approved person fails or ceases to be so approved, such person's holdings will immediately be reduced to less than 5% of the outstanding securities of any class either through redemption, conversion or sale to another securities holder.

10. A securities holder, other than an officer or director, beneficially owning 5% or more of any class of freely transferable securities of an issuer, directly, indirectly or through an affiliate or associate, is required to be an "approved person" approved by the Director. A securities holder losing such approval shall reduce his holdings to less than 5%.
11. The chief executive officer of each issuer shall advise the Director forthwith upon the issuer learning that any person not an officer or director of the issuer beneficially owns 5% or more of the outstanding securities of any class and shall submit to the Director at such times as the Director may require an affidavit listing to the best of his knowledge and belief the name of each party not an officer or director of the issuer beneficially owning 5% or more of the outstanding securities of any class.
12. No more than 20% of the interest of each of the securities holders of an issuer as of the date of the initial public issue may be offered in each year of the first five years from the date of the initial filing unless otherwise approved by the Director.
13. Any issuer which has outstanding debt securities subject

to the subordinated loan agreement requirements in a form acceptable to the Commission must maintain not less than \$2.00 of share capital outstanding for each \$1.00 of such debt.

14. An issuer shall not be permitted to make loans secured by securities of its own issue, or to accept such securities for margin purposes.
15. When an initial offering has been made by an issuer to approved persons as permitted by Appendix "K" of this Report, no other distribution to the public may be made by that issuer of its securities or by holders of its securities for a period of at least one year after the termination of the Appendix "K" offering; provided, however, offerings made solely to industry investors (as defined in Appendix "K") shall not be prohibited.
16. An issuer may sell its own securities on a best efforts basis, or through an underwriting in which latter case it may participate as a member of the selling group in the distribution of an issue of its own securities or those of an affiliate, but:
 - (a) the price at which the issue is to be distributed to the public shall be no higher than that recommended by two qualified independent dealers (acceptable to the Director) who may also be underwriters, but if they are not underwriters they shall participate in the preparation of the prospectus or statement of material facts and certify the same as though they were under-

writers; and

- (b) the two dealers referred to above shall be represented by legal counsel independent of the issuer who shall review the information contained in the prospectus or statement of material facts, and issue an opinion as to whether it conforms to all requirements of the appropriate corporate and securities laws.

17. An issuer, after the completion of the distribution of its freely transferable securities, is prohibited from effecting any transaction (except on an unsolicited basis) for the account of any customer in, or making any recommendation with respect to, any such security issued by it.

APPENDIX "K"

RULES FOR LIMITED OUTSIDE INVESTMENTS IN SECURITIES FIRMS
(AS ADOPTED WITH AMENDMENTS AND DELETIONS FROM THE MOORE
REPORT)

PART A

1. In this Appendix,

(a) "industry investors" means investors associated with a particular dealer who have been approved by the Commission in accordance with procedures then in effect and who are:

- (i) full-time officers and employees;
- (ii) retired officers or employees, provided that a retired officer or employee should not be permitted to acquire additional voting or participating securities of the dealer unless he satisfies all requirements applicable to approved investors and that the Commission shall review such persons to guard against use of this provision to avoid the restrictions on approved investors;
- (iii) a holding company if:
 - (A) a majority of each class of its voting shares is held by individuals referred to in (i) or (ii); and
 - (B) satisfactory arrangements are made so that the investment of the holding company in the dealer is subject to the same requirements to which it would be subject if owned by an individual referred to in (i) or (ii);

- (iv) a registered retirement savings plan established by an individual referred to in (i) or (ii) under the Income Tax Act (Canada) or equivalent provisions if control over the investment policy of the plan is held by such individual and if no other person has any beneficial interest in the plan;
- (v) a pension fund established by such dealer for its officers and employees, if;
 - (A) the pension fund is so organized that full power over its investment portfolio and the exercise of voting and other rights attaching to instruments and securities contained in the portfolio is held by individuals referred to in (i); and
 - (B) satisfactory arrangements are made so that the instruments and securities contained in the portfolio are subject to the same restrictions to which they would be subject if owned by an individual referred to in (i) or (ii);
- (vii) the estate of an individual referred to in (i), (ii) or (v), for a period of one year after the death of such individual or such longer period as may be permitted by the Commission; and
- (viii) dealers affiliated with or a partner of the dealer in which the investment is made, or who will control the dealer when the investment is made.

- (b) "approved investors" are those persons approved by the Commission through an application under section 59 of The Securities Act. Approved investors will include family trusts, personal holding corporations and financial institutions where the financial institutions purchase debt securities which are subject to the subordinated loan agreement requirements in a form acceptable to the Commission.
- (c) "approved lenders" are the following "financial institutions":
- (i) a bank to which the Bank Act (Canada) applies;
 - (ii) the Industrial Development Bank incorporated under the Industrial Development Bank Act (Canada);
 - (iii) a loan corporation or trust company registered under The Loan and Trust Corporations Act;
 - (iv) an insurance company licensed under The Insurance Act;
 - (v) the Government of Canada, provincial governments, any municipal corporation or public board or commission in Canada;
 - (vi) a credit union duly registered under The Credit Union Act.

PART B

1. The aggregate investment of approved investors in a dealer (apart from non-subordinated debt) should at no time exceed 40% of the firm's capital here defined to mean issued, outstanding and fully paid shares, contributed and earned surpluses, and reserves, if any.

2. Only industry investors and approved investors

should be permitted to acquire investments in or securities issued by dealers other than the securities issued to secure the ordinary course indebtedness to approved lenders.

3. A dealer which has outstanding subordinated debt owned by approved or industry investors should be required to maintain not less than two dollars of share capital for each dollar of subordinated debt. A dealer shall not be permitted to make loans secured by securities of its own issue, or to accept such securities for margin purposes.

4. Any money raised by way of debt securities from approved investors must be by way of subordinated debt.

5. The maximum percentage of voting securities which may be held by approved investors at any time shall be 25%.

6. Excepting for a non-resident securities firm approved by the Commission and permitted to hold up to 25% of the voting shares, no approved investor shall be permitted to hold more than 5% of the voting shares.

7. The number of approved investors holding shares shall at no time exceed 25.

PART C

1. Each dealer in which approved and industry investors have an investment shall make arrangements acceptable to the Commission whereby each approved or industry investor is obligated to dispose of his investment upon withdrawal of his approval as an approved or industry investor, or upon his bankruptcy, insanity or death.

2. Dealers seeking capital from approved investors shall be corporations other than private companies,

or partnerships in which the approved investors are limited partners under The Limited Partnerships Act.



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